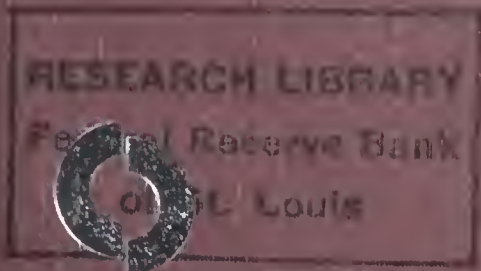


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Administration of National Banks

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Comptroller

Robert L. Clarke

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Background

The Office of the Comptroller of the Currency (OCC) was established in 1863 as a bureau of the Department of the Treasury. The OCC is headed by the Comptroller who is appointed by the President, with the advice and consent of the Senate, for a 5-year term.

The OCC regulates national banks by its power to:

- Approve or deny applications for new charters, branches, capital or other changes in corporate or banking structure;
- Examine the banks;
- Take supervisory actions against banks which do not conform to laws and regulations or which otherwise engage in unsound banking practices, including removal of officers, negotiation of agreements to change existing banking practices and issuance of cease and desist orders; and
- Issue rules and regulations concerning banking practices and governing bank lending and investment practices and corporate structure.

The OCC divides the United States into six geographical districts with each headed by a Deputy Comptroller

The Office is funded through assessments on the assets of national banks

The *Quarterly Journal* is the journal of record for the most significant actions and policies of the Office of the Comptroller of the Currency. It is published four times a year in March, June, September and December. The *Quarterly Journal* includes policy statements, decisions on banking structure, selected speeches and testimony, material released in the interpretive letter series, summaries of enforcement actions, statistical data and other information of interest to the administration of national banks. Suggestions, comments or questions may be sent to Tibby Ford, Editor, Communications Division, Office of the Comptroller of the Currency, Washington, DC 20219. Subscriptions are available for \$60 a year by writing to Publications—OCC, Office of the Comptroller of the Currency, Washington, DC 20219.

The Comptroller

Robert Logan Clarke became the 26th Comptroller of the Currency on December 10, 1985.

By statute, the Comptroller serves a concurrent term as a Director of the Federal Deposit Insurance Corporation and as a member of the Federal Financial Institutions Examination Council.

An attorney, Mr. Clarke was formerly with the law firm of Bracewell & Patterson in Houston, Texas. He joined the firm in 1968 and founded its Banking Section in 1972.

Mr. Clarke received a B.A. degree from Rice University in 1963 and an LL.B. degree from Harvard University Law School in 1966. He served as a Captain in the United States Army from 1966 to 1968.

Quarterly Journal



Office of the Comptroller of the Currency

Robert L. Clarke

Comptroller of the Currency

The Administrator of National Banks

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Operations of National Banks

Diverging Fortunes Characterize 1987 Results

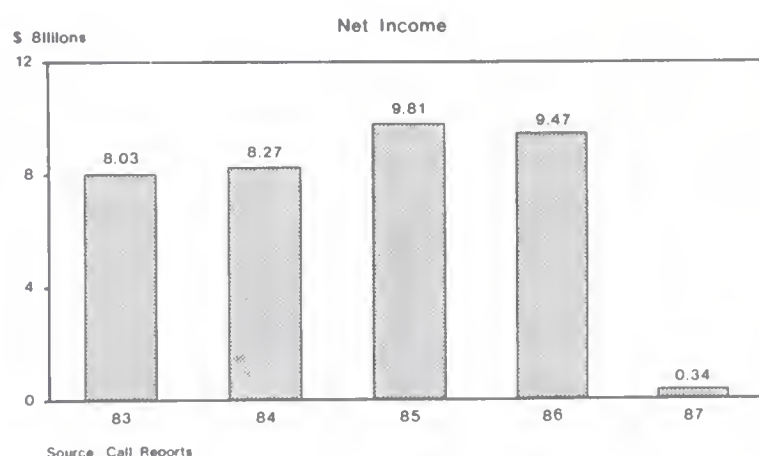
1987 was a turbulent year for national banks. Their aggregate earnings plunged more than 95 percent, the greatest decline in profits since the Great Depression. More than one national bank in five lost money and failures continued to mount. Failures of national banks increased for the sixth consecutive year, rising more than 25 percent in 1987 alone.

In spite of this, the majority of banks, with the conspicuous exception of large and Southwestern banks, realized some improvement in profitability and credit quality in 1987. Net operating income increased following 5 years of decline. There were fewer nonperforming assets than there had been in 2 years, and the rate at which national banks were charging off loans declined for the first time in 5 years.

Profits Plunged Due to Special Provisions for LDC Debt

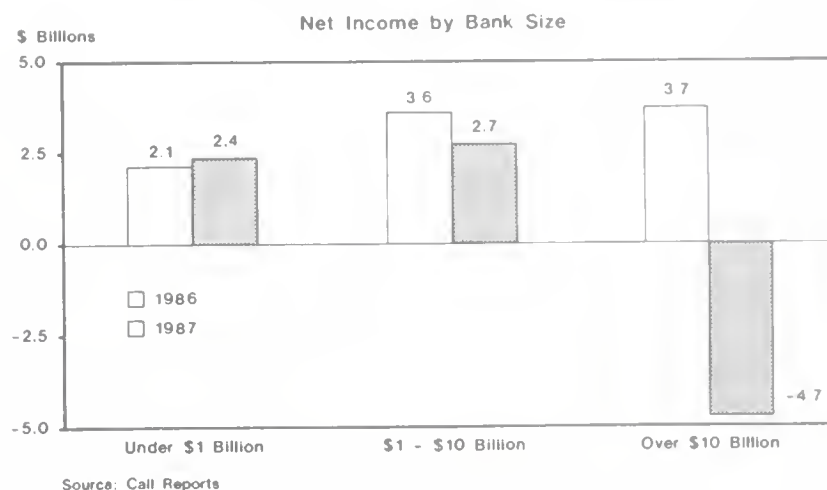
The aggregate earnings of national banks dropped by more than \$9 billion in 1987.

PROFITS OF NATIONAL BANKS PLUNGED IN 1987



National banks, as a group, earned only \$338 million last year, down from more than \$9 billion in 1986. Profits were depressed by losses recorded by the largest national banks, those with assets of more than \$10 billion. These 29 banks lost nearly \$5 billion in 1987. National banks with less than \$1 billion in assets actually earned more in 1987 than they had in 1986.

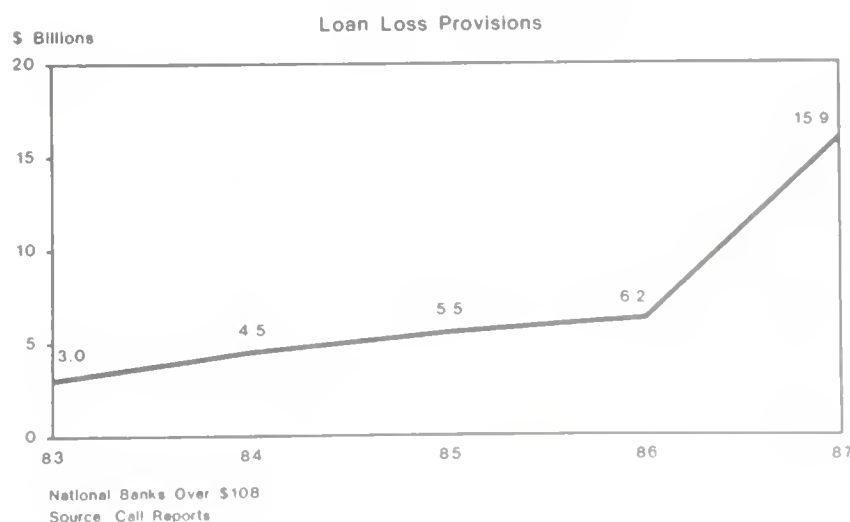
LARGE BANK LOSSES OFFSET PROFITS AT SMALLER BANKS



Although the 29 largest national banks make up less than 1 percent of all national banks, they control over 45 percent of national bank assets. Thus, problems among these banks can have a profound effect on the aggregate results for all national banks. In 1987, losses at these large national banks nearly offset the earnings at the more than 4,500 smaller national banks.

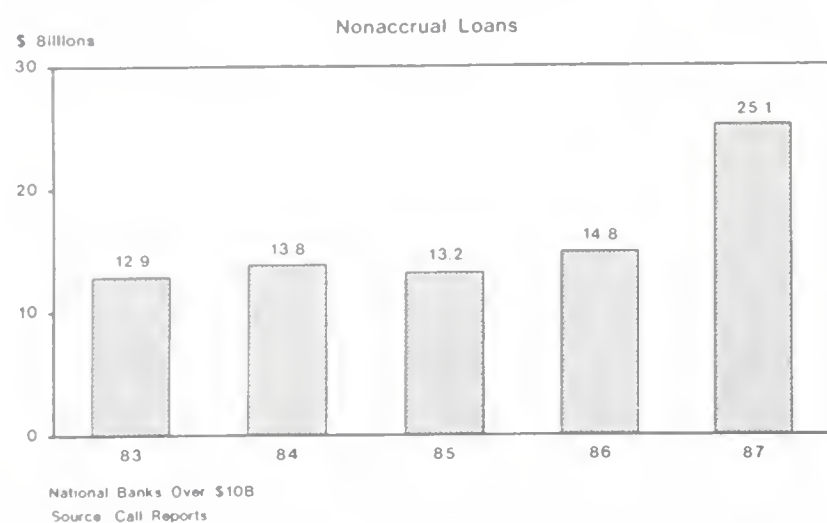
Losses at large banks stemmed largely from provisions for loan losses attributable to their problem credits to developing countries. In 1987, loan loss provisions at these banks jumped by more than \$9.7 billion, to \$15.9 billion, as the difficulties that many developing countries face in servicing their debt became more widely recognized. This group of banks alone accounted for more than \$37 billion in loans to the four largest Latin American debtors — Mexico, Venezuela, Argentina, and Brazil.

LOAN LOSS PROVISIONS SKYROCKETED AT LARGE NATIONAL BANKS



Large banks were also affected by the Brazilian government's suspension of interest payments on their loans and the growing recognition that the ability of many other developing countries to service their debts was being impaired by worsening economic conditions. An increasing number of these loans were placed on nonaccrual status: nonaccrual loans were up 70 percent at the large banks. As nonaccruals have increased, these banks have suffered a reduction in their interest income resulting in a corresponding deterioration in their bottom line.

NONACCRUAL LOANS INCREASED 70% AT LARGE BANKS

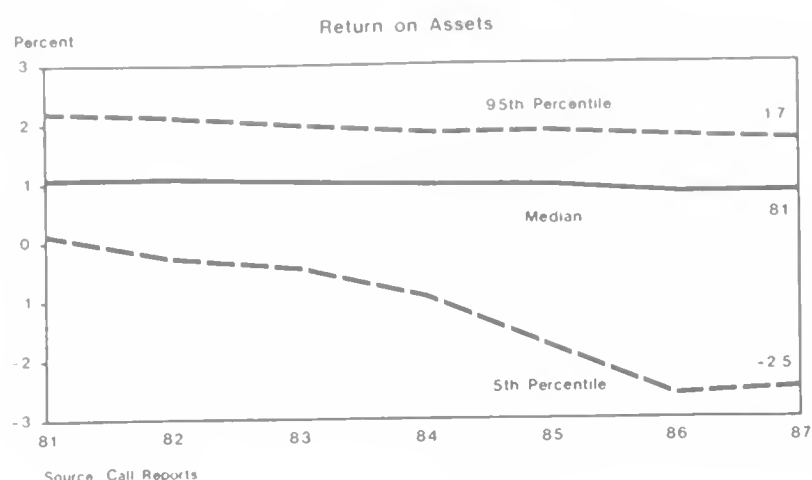


Profitability Firmed for Most Banks After Years of Decreases

With earnings of \$338 million from assets of \$1.8 trillion, the aggregate return on assets (ROA) for the national banking system was a mere 0.02 percent in 1987, its lowest level in more than 50 years. But most national banks achieved considerably higher profitability than the average suggested by the aggregates. Half of all the national banks realized an ROA of 0.81 percent or higher. This median ROA was well below its peak of 1.09 in 1981, but just one basis point below its level in 1986.

Declining ROA has been a persistent phenomenon during the past 6 years. The fall in profitability has been particularly pronounced among the banks with the weakest earnings; an increasing number of banks have become unprofitable and the severity of their losses has increased. As a result, the spread between the strongest and weakest earnings performance has broadened substantially. In 1987, for the first time in 6 years, the dispersion in profitability narrowed, but remained substantially wider than the range existing 10 years ago. Dispersion of performance is widest among banks with ROAs below the median.

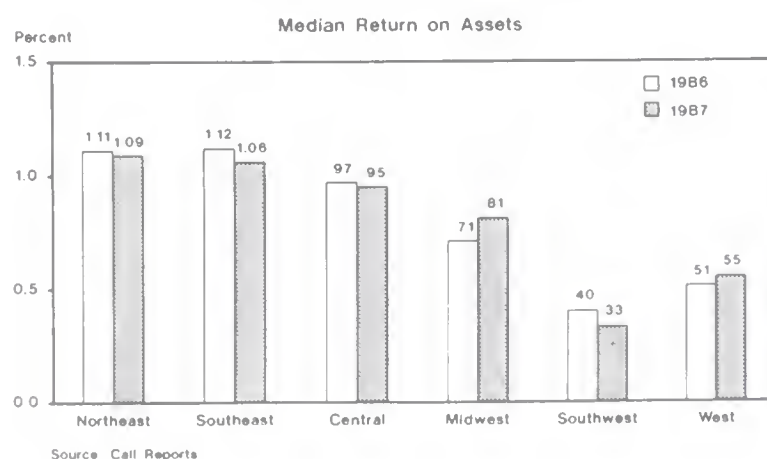
POOR PERFORMERS CONTINUED TO STRUGGLE



Conditions Worsened in the Southwest

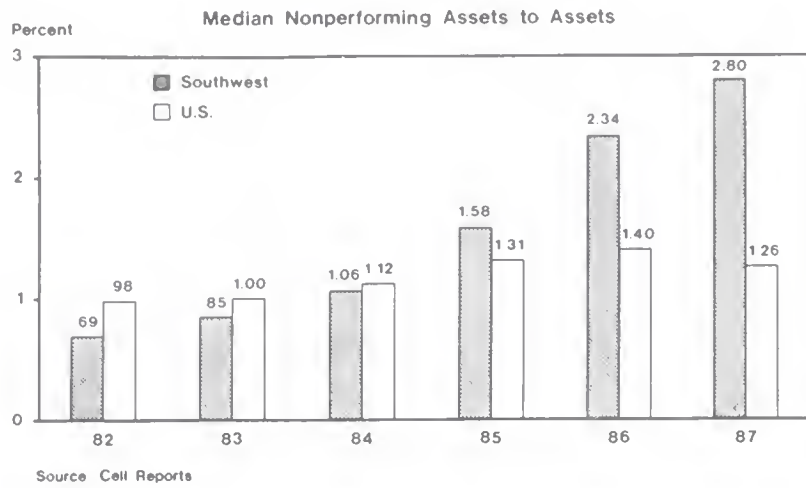
The gravest weaknesses for the past 2 years have existed in the OCC's Southwestern District, where more than one bank in three was unprofitable in both 1986 and 1987. Median ROA last year among banks in the Southwestern District was less than half the national median.

THE PROFITABILITY OF SOUTHWESTERN BANKS REMAINED DEPRESSED



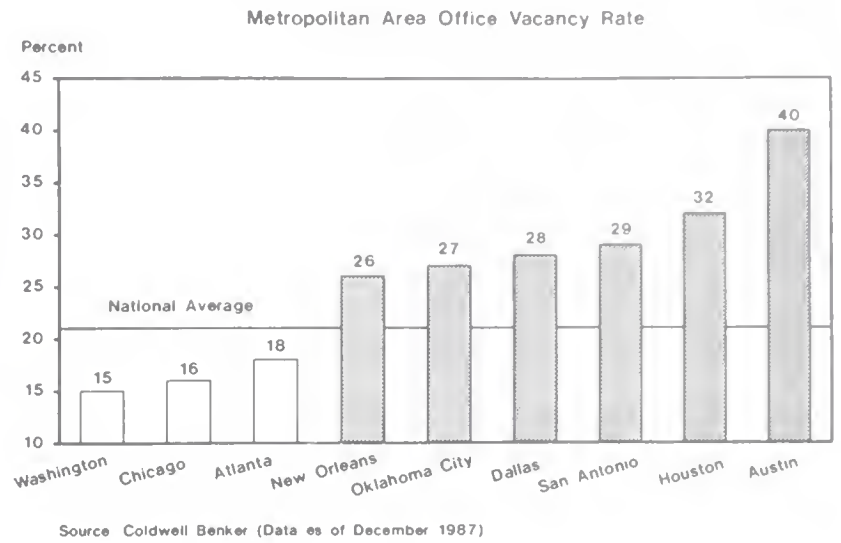
Profitability of Southwestern banks has been squeezed by high and rising levels of nonperforming assets. Nonperforming assets have increased fourfold in just 5 years among national banks in the Southwestern District and now amount to 2.8 percent of assets, more than twice the national rate.

CREDIT QUALITY WORSEENED AGAIN IN THE SOUTHWEST



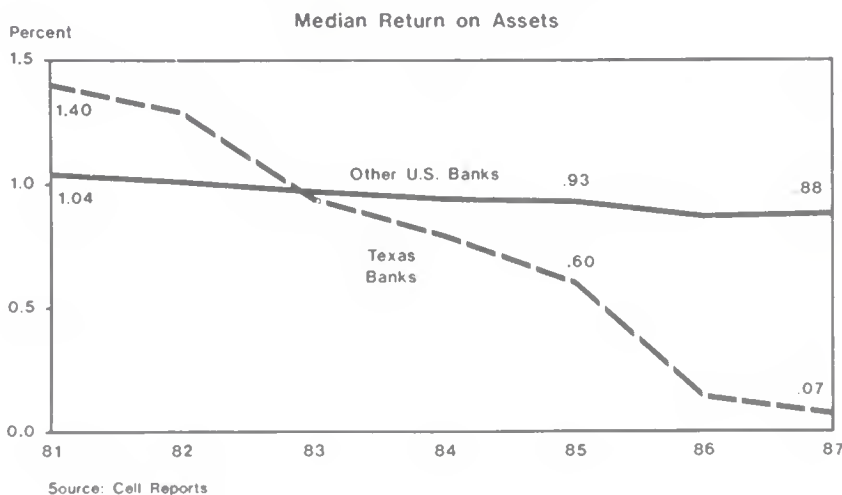
Problems have been particularly severe in Texas where more than 40 percent of the national banks were unprofitable in 1987 and where the median ROA fell from 1.40 percent in 1981 to just 0.07 percent in 1987.

OFFICE GLUT PERSISTS IN THE SOUTHWEST



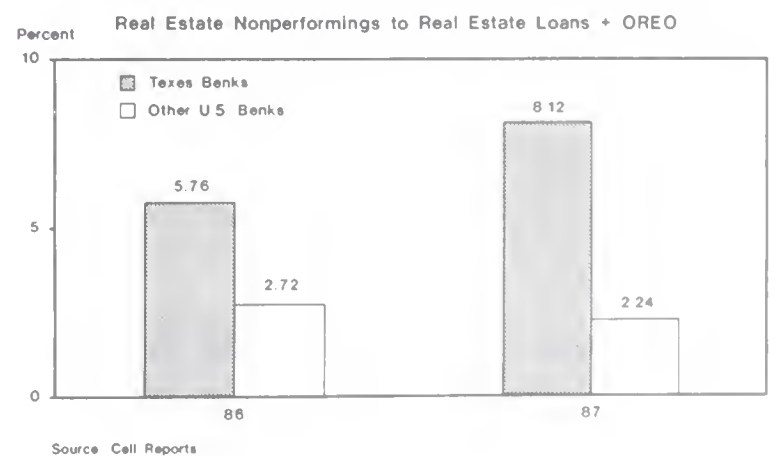
The dramatic decline in economic fundamentals has caused substantial problems to surface in the loan portfolios of Southwestern banks. The problems are severe in Texas, particularly among banks that have engaged in extensive commercial real estate lending. More than 8 percent of real estate loans in Texas are nonperforming, about 4 times the nonperforming rate for banks outside of Texas.

BANK PROFITABILITY IN TEXAS SLID FOR THE SIXTH CONSECUTIVE YEAR



Soaring economic growth, fueled by the boom in energy production, precipitated a surge in commercial construction in the Texas and the Southwest earlier this decade. When oil prices fell, construction collapsed. But the damage had already been done; office vacancy rates quadrupled in some cities. The most severe cases occurred in Texas, but Oklahoma and Louisiana were hit hard as well.

REAL ESTATE NONPERFORMINGS GREW IN TEXAS WHILE THE NATIONAL RATE DECLINED

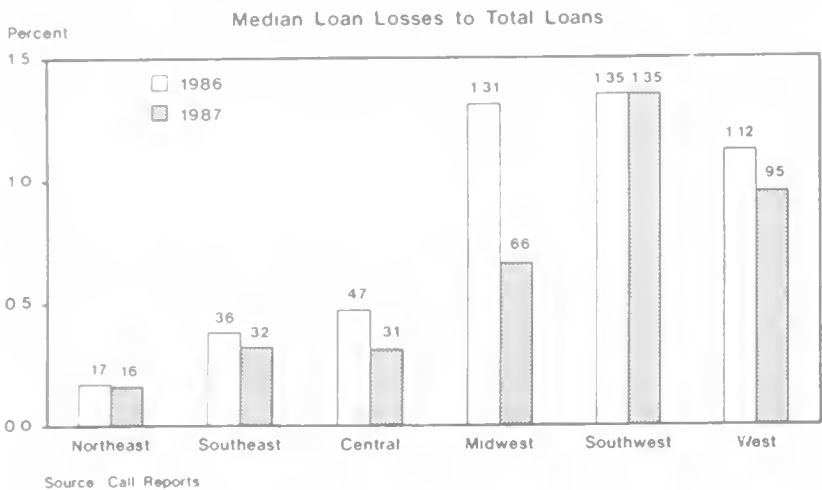


Sales and employment data in the second half of 1987 suggest that the trough of economic activity in Texas and other portions of the Southwestern District may have been reached. A turnaround in the fortunes of Southwestern banks, especially those saddled with nonperforming real estate loans, could take considerable time. The relatively high rate of business failures and the overhang of vacant properties is too severe to be alleviated quickly by modest improvements in business activity.

Credit Quality Improved for Many National Banks

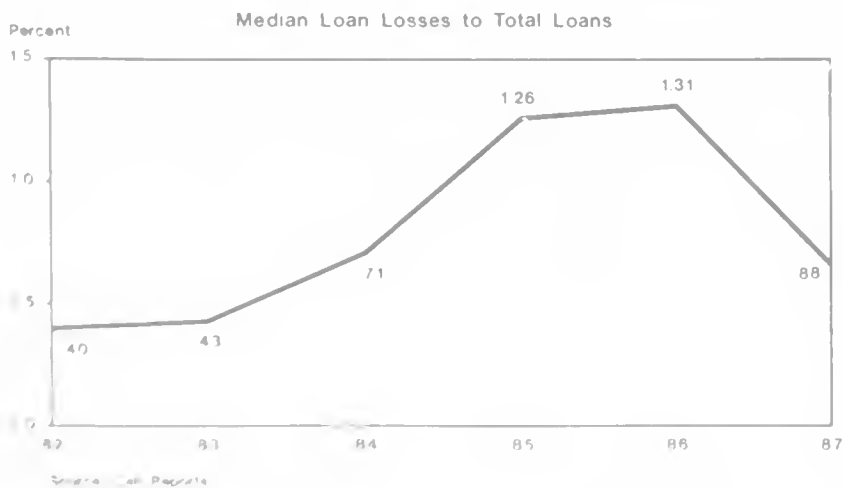
Although credit quality problems linger in the Southwest, the majority of banks realized some improvement in their asset portfolios in 1987, especially smaller banks outside the OCC's Southwestern District. Relative to total loans, for example, the median level of nonperforming loans fell by 10 percent and the median level of net loan losses fell by more than 25 percent between 1986 and 1987.

LOAN LOSSES DECLINED IN ALL BUT THE SOUTHWEST DISTRICT



The greatest improvement occurred in the OCC's Midwestern District. One important factor was the modest improvement in farm sector conditions, particularly in the second half of the year. Relative to total loans, nonperforming loans in the Midwestern District declined more than 30 percent, and loan losses were halved.

LOAN LOSSES DECLINED IN THE MIDWEST FOR THE FIRST TIME IN FIVE YEARS

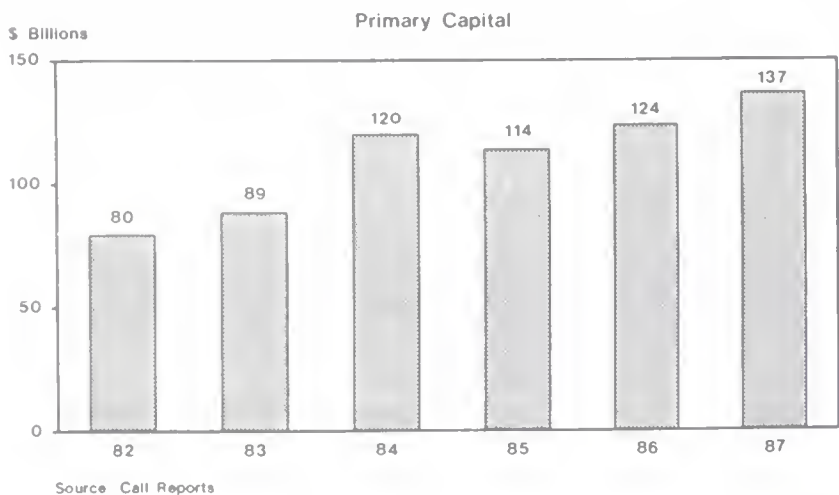


The reduction in nonperforming assets and loan losses in the Midwest reduced the pressure on earnings in Midwestern banks; their net operating profits rose by more than a third. As indicated in an earlier chart, median ROA was 0.81 percent among Midwestern District banks, still below the levels recorded in the Northeastern, Southeastern, and Central districts, but up by more than 10 percent over 1986.

Primary Capital Ratios Rose in 1987

Primary capital at national banks has steadily increased in recent years, rising from \$80 billion in 1982 to \$137 billion in 1987. The trend has been particularly pronounced among the largest banks, which have increased primary capital by \$26 billion in the past 5 years. The median primary capital ratio among national banks was 8.44 percent in 1987, up from 8.19 percent in 1986.

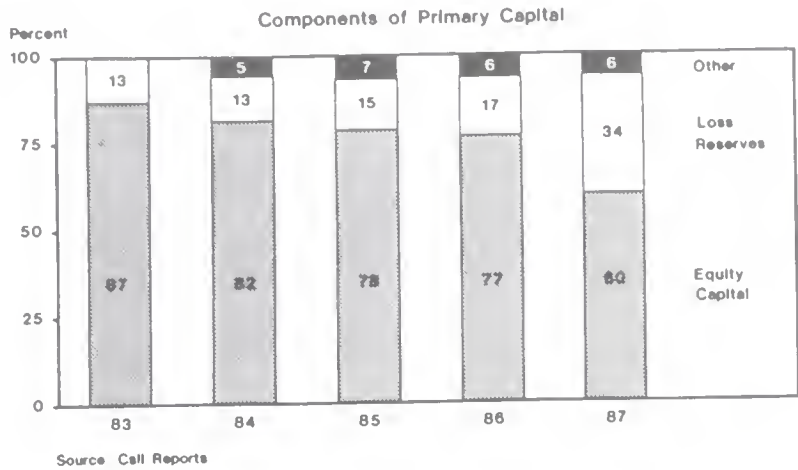
NATIONAL BANKS INCREASED THEIR PRIMARY CAPITAL



An interesting development, however, has been the substitution of loan loss reserves for equity capital in the primary capital base at many banks. This has been especially true among the large banks in the wake of the provisions taken, most in the second quarter of 1987, against loans to developing countries.

At the large banks, the decision to bolster loan loss reserves resulted in a substantial decline in equity capital in the first half of 1987. This prompted a number of them to issue new equity within months of making those special provisions. The plunge in stock prices in October, however, delayed further offerings. Thus, at yearend 1987, one-third of the primary capital at the large banks was in the form of loan loss reserves, twice the share of 1 year before.

RESERVES ARE A THIRD OF PRIMARY CAPITAL AT LARGE BANKS



National Bank Failures Increased

National bank failures increased for the sixth consecutive year; 61 national banks failed in 1987, up from 48 in 1986. Two Southwestern District states, Texas and Oklahoma, however, accounted for two-thirds of the national bank failures in 1987.

NATIONAL BANK FAILURES WERE CONCENTRATED IN TEXAS AND OKLAHOMA



Rose W. Ho
Stephen Cross
Industry & Financial Analysis Division

Summary statistics for national banks by district
(Data through fourth quarter 1987)

	Northeastern	Southeastern	Central	Midwestern	Southwestern	Western	U S
<u>Bank Aggregate</u>							
Number of Banks	496	530	916	745	1,347	559	4,593
Total Assets (\$ Billion)	629	253	287	118	188	295	1,770
Net Income (\$ Million)	-1,380	2,244	387	694	-1,385	-222	338
Standbys & Commitments (\$ Billion)	212	45	80	19	37	127	520
Percent of Banks with Losses	8.06	12.45	6.44	11.28	40.39	31.31	21.08
Number of Failed National Banks	3	0	1	5	40	12	61
Number of Problem National Banks	3	6	20	42	198	46	315
<u>Performance Measures (Medians)¹</u>							
<u>Profitability (%)</u>							
Return on Equity	14.14	12.88	11.74	10.41	4.22	6.98	10.00
Return on Assets	1.09	1.06	0.95	0.81	0.33	0.56	0.81
Yield on Assets	8.78	8.76	8.44	8.39	8.40	8.61	8.50
Cost of Funding Assets	4.62	4.59	4.73	4.72	4.77	4.16	4.64
Net Interest Income to Assets	4.22	4.16	3.74	3.66	3.69	4.57	3.87
Loss Provision to Assets	0.20	0.28	0.23	0.32	0.75	0.58	0.37
Noninterest Income to Assets	0.51	0.73	0.52	0.59	0.80	0.97	0.68
Noninterest Expense to Assets	3.08	3.32	2.83	2.92	3.45	4.38	3.20
Net Operating Income to Assets	1.07	1.02	0.91	0.77	0.25	0.51	0.75
<u>Asset Quality (%)</u>							
Nonperforming Assets to Loans & OREO	0.99	1.31	1.70	2.59	5.41	3.73	2.48
Loss Reserve to Loans	1.00	1.17	1.25	1.67	1.87	1.63	1.43
Net Loss to Loans	0.16	0.32	0.31	0.66	1.35	0.95	0.57
<u>Funding & Liquidity (%)</u>							
Net Loans & Leases to Assets	62.41	57.54	52.56	47.04	52.33	57.15	53.81
Wholesale Funds to Deposits	7.21	11.01	6.47	5.61	20.42	10.88	10.07
<u>Capital (%)</u>							
Total Capital to Assets	8.35	8.76	8.56	8.68	8.42	8.57	8.56
Primary Capital to Assets	8.22	8.67	8.48	8.56	8.28	8.43	8.44
Equity Capital to Assets	7.62	8.01	7.81	7.75	7.39	7.41	7.65
<u>Growth Rates (%)</u>							
Assets	7.46	6.53	3.19	1.81	1.90	0.50	3.21
Equity Capital	10.74	8.43	6.45	5.66	0.77	4.81	5.67
Net Loans & Leases	16.88	12.81	7.96	2.91	-1.78	0.42	5.53

¹Medians are for established banks, established banks exclude new banks.

²Problem banks have composite CAMEL ratings of 4 or 5

Industry & Financial Analysis

Summary statistics for national banks
(Data through fourth quarter 1987)

	12/31/83	12/31/84	12/31/85	12/31/86	12/31/87	12/31/87			
						Over \$10B	\$1B-\$10B	\$0-\$1B¹	New Banks²
Banking Aggregates									
Number of Banks	4,709	4,857	4,907	4,818	4,593	29	182	4,174	208
Total Assets (\$ Billion)	1,392	1,495	1,627	1,735	1,770	795	567	405	3
Net Income (\$ Million)	8,031	8,272	9,810	9,468	338	- 4,736	2,730	2,369	- 26
Standbys & Commitments (\$ Billion)	375	434	483	494	520	359	135	26	0
Percent of Banks with Losses	13.04	16.22	19.60	23.35	21.08	48.28	13.74	18.71	71.15
Number of Failed Commercial Banks	9	17	30	48	61	0	0	53	8
Number of Problem National Banks	130	198	266	350	315				
Performance Measures (Medians)¹									
Profitability (%)									
Return on Equity	12.76	12.33	11.97	10.26	10.00	0.69	13.67	9.94	- 5.85
Return on Assets	1.02	0.97	0.94	0.82	0.81	0.03	0.86	0.81	- 1.13
Yield on Assets	10.37	10.72	10.12	9.10	8.50	8.02	7.96	8.53	8.24
Cost of Funding Assets	6.27	6.71	5.97	5.19	4.64	4.88	4.40	4.65	4.07
Net Interest Income to Assets	4.10	4.02	4.13	3.90	3.87	3.31	3.59	3.89	3.88
Loss Provision to Assets	0.27	0.32	0.44	0.50	0.37	1.68	0.57	0.36	0.45
Noninterest Income to Assets	0.59	0.65	0.67	0.67	0.68	1.29	1.29	0.66	0.85
Noninterest Expense to Assets	3.09	3.09	3.19	3.22	3.20	3.11	3.40	3.20	5.19
Net Operating Income to Assets	1.01	0.97	0.87	0.67	0.75	- 0.14	0.81	0.75	- 1.11
Asset Quality (%)									
Nonperforming Assets to Loans & OREO	2.04	2.13	2.50	2.75	2.48	3.57	1.69	2.53	0.43
Loss Reserve to Loans	1.02	1.06	1.19	1.33	1.43	3.45	1.47	1.42	0.98
Net Loss to Loans	0.38	0.41	0.61	0.77	0.57	0.68	0.66	0.56	0.14
Funding & Liquidity (%)									
Net Loans & Leases to Assets	49.88	53.77	53.67	52.42	53.81	62.02	62.85	53.22	56.88
Wholesale Funds to Deposits	8.20	9.34	9.88	9.31	10.07	37.14	15.66	9.80	23.22
Capital (%)									
Total Capital to Assets	8.41	8.38	8.42	8.31	8.56	7.74	7.50	8.64	12.87
Primary Capital to Assets	8.24	8.24	8.27	8.19	8.44	7.10	7.18	8.52	12.75
Equity Capital to Assets	7.71	7.61	7.62	7.44	7.65	4.81	6.13	7.75	11.88
Growth Rates (%)									
Assets	9.61	8.02	7.01	6.79	3.21	5.32	4.53	3.16	24.01
Equity Capital	9.21	8.41	8.12	6.45	5.67	- 1.15	8.88	5.55	- 4.52
Net Loans & Leases	10.80	14.14	6.51	4.37	5.53	6.45	8.18	5.31	36.14

¹Data are for established banks unless otherwise noted; established banks exclude new banks.

²New banks are banks that have been in operation less than 3 years and have assets less than \$25 million.

Industry & Financial Analysis

Recent Corporate Decisions

On January 15, 1988, the Office granted preliminary conditional approval to an application for the establishment of a de novo distributive bank "Collecting Bank, National Association." This was the first de novo distributive bank approved by the Office. The Office's approval took into account the fact that the proposal was an integral part of a federally assisted recapitalization plan for First City Bancorporation of Texas, Inc. (First City). The organizers were seeking to establish Collecting Bank so that it could acquire substantially all problem credits and certain other assets from the subsidiary banks of First City, enabling the recapitalized company to have a "fresh start." As was the case in two earlier distributive banks which were created in connection with other recapitalization plans, Collecting Bank will go into voluntary liquidation immediately after receiving its charter. The preliminary approval letter stipulated that the organizers must satisfy numerous conditions before the Office would issue final approval of the charter. In addition, the directors of the proposed bank were required to enter into a formal agreement with the Office to ensure the orderly liquidation of the bank.

During 1987, the Office received a letter of notification from Norwest Bank, N.A., Minneapolis, Minnesota, stating its intent to engage, through an operating subsidiary, in all securities-related activities previously approved by the Office, and all authorizations the Office grants in the future. On February 12, 1988, the Office granted approval for the bank to engage in the securities-related activities specified in its letter of notification. However, the bank's request to engage in all activities the Office might approve in the future was disapproved. The Office found the latter request to be in conflict with the Office's licensing and supervisory policies which require the Office to ascertain the legality and soundness of each new activity proposed to be performed in an operating subsidiary.

On February 17, 1988, the Office approved a proposal by Chase Manhattan Bank, N.A., New York, New York, to establish an operating subsidiary to underwrite pools of commercial real estate loans. In an earlier decision, in June 1987, the Office permitted Security Pacific National Bank, Los Angeles, to securitize its own residential mortgages through a subsidiary. The Chase Manhattan decision extends the principle of allowing national bank subsidiaries' underwriting of asset-based securities

to pools of commercial real estate loans.

On February 19, 1988, the Office approved the acquisition of a national trust company (First Trust Company of Florida, N.A., Sarasota, Florida) by a nonbank bank (Bank of Boston-Florida, N.A., Palm Beach, Florida) which became a bank under the grandfather provisions of the Competitive Equality Banking Act (CEBA). In the approval letter, Bank of Boston-Florida, N.A. was reminded of CEBA restrictions on bank's activities and the number of locations from which the resulting bank could operate.

Last year, the Office received an application from the City National Bank of Hoopeston, Illinois (CNB), to relocate its main office from Hoopeston to Danville, Illinois, and to retain a branch at its former main office site. Due to Illinois' home office protection law, which prohibits a bank from establishing a branch within 1 mile of another bank's head office, this was the only way CNB could legally establish an office in the Danville market. The unusual aspect of this case was the fact that a competing bank placed a trailer next to the applicant's present head office site and designated the trailer as its head office. This action was taken to prevent the applicant from retaining its present site as a branch, since the branch would now be within 1 mile of the competing bank's new head office. Because the trailer facility did not offer a full range of services, a legal argument developed between the competing banks as to what constituted a main office. After due consideration of the facts, the Office opined that the trailer operation qualified as a head office. Consequently, on February 22, 1988, the Office approved CNB's request to relocate its head office, but denied the bank's request to retain its former main office site as a branch.

In a situation similar to the Midlantic case described in Volume 7, Number 1 of the Quarterly Journal (pages 32 and 33), on March 7, 1988, the Office notified First Fidelity Trust, N.A., Boca Raton, Florida, a national trust company, that it could expand its operations pursuant to the grandfather provisions of the Competitive Equality Banking Act of 1987 (CEBA). First Fidelity submitted various documents in support of its belief that it was a "bank" under the expanded definition in CEBA, and that it was not exempt from this definition because it did not meet the conditions for trust institutions.

Litigation Update

The Litigation Division represented the OCC in a major case involving a bank closing. *Golden Pacific Bancorp., et al. v. Clarke*, No. 87-504 (Slip op., January 26, 1988, D.C. Cir.). The Court of Appeals before which the case has been pending recently upheld a lower court's dismissal of a tort action against the OCC. The Court ruled that neither the Administrative Procedure Act nor the Federal Tort Claims Act (FTCA) permits the courts to entertain such actions, since the OCC's action in closing a bank falls within the "discretionary function" exemption to suits under the FTCA. Citing 12 U.S.C. § 91 the Court stated, "the decision to close the bank . . . could not possibly be thought of as other than a discretionary act that was committed by Congress to the Comptroller's judgment." A connection between the Comptroller's power to regulate the safety and soundness of banks and his power to declare banks insolvent was made by the Court when it stated that the Comptroller "must make innumerable subtle judgments in describing the content of safe and sound bank practices — judgments that draw upon a mix of law, accounting, bank custom, and policy. Sometimes, as here [i.e., in closing this bank], those determinations must be made under grave pressure and expeditiously." In so holding, the Court stated that the District Court had gone too far by even considering whether the Comptroller's action was improper.

In another important case in which the Litigation Division represented the OCC, the U.S. Supreme Court recently refused to hear an appeal from a lower court's decision in *OCC v. LeMaire, et al.*, No. 86-1761. The effect of this decision is to support the position taken by the OCC under 12 U.S.C. § 91 that a judgment entered against a national bank may not be executed upon until there is no further right to appeal that judgment.

OCC's involvement in this litigation resulted from a Texas State Court's entry of a judgment against MBank, Abilene, Texas, in an amount exceeding the bank's capital and surplus accounts. In Texas, a plaintiff may ordinarily seize property to satisfy a judgment notwithstanding a pending appeal unless a bond in the full amount of the judgment is posted. Federal law, at 12 U.S.C. § 91, provides that execution of a judgment against a national bank may not occur until judgment is "final." To prevent execution of the judgment against MBank, OCC filed suit in federal District Court, contending that a judgment is not "final" within the meaning of federal law unless the

judgment is no longer appealable. The District Court adopted OCC's position and issued a preliminary injunction to prevent execution of the outstanding judgment and the Court of Appeals upheld the District Court's decision.

In the disclosure area, the Litigation Division represented the OCC in a case before a U.S. District Court in which the Court rejected an attempt by a consumer group to obtain bank-identifying information in OCC consumer compliance data bases pursuant to a Freedom of Information Act request. In denying the consumer group's access to the information the Court ruled that OCC could withhold bank charter numbers that are keyed to consumer complaints, "[i]rrespective of the fact that consumers provided" the banks' identity to the OCC.

This case marks the first time a federal District Court has held that a federal banking agency may withhold the banks' identities with respect to consumer complaint letters. In so holding, the Court read the language of exemption 8 of the Freedom of Information Act quite broadly, noting that "the all-inclusive exemption 8 covers information contained in or related to reports that might not undermine confidence" in banking system. The Court held that even if the information being sought in OCC files is harmless the information may be withheld by the OCC if it is germane to bank examination reports.

The Litigation Division also participated in a case concerning merger approvals. *Washington, et al. v. OCC, et al.*, CV487-288 (S.D. Ga.). In this case, the OCC was sued by a community group which opposed the OCC's decision not to hold a public hearing on the proposed merger of the First National Bank of Savannah with and into the First Union National Bank of Georgia. In dismissing the case, the District Court ruled that the "OCC denied the hearing request after carefully considering the reasons advanced for the request in the context of applicable law," and that "the Comptroller's approval of the merger . . . was not arbitrary and capricious, and abuse of discretion, or otherwise not in accordance with law." The community group has appealed the District Court decision to the Circuit Court of Appeals for the Eleventh Circuit.

Yvonne McIntire
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Remarks by Robert L. Clarke, Comptroller of the Currency, before the Midwinter Meeting of the Association of Reserve City Bankers, Washington, D.C., February 2, 1988

I'm sorry you all decided to arrive in Washington at the worst possible time — this last weekend. January is often the cruelest month in this town. For weeks, tension has risen, tempers have flared and friends have turned against friends. Thank God the Superbowl is over and the people in Washington can get back to business and deal with each other — and the rest of the world — as adults.

Actually, football and politics have a lot in common, which is why the Redskins are so loved in this town — when they win. Football players — like elected officials — are in the business of running, dodging, blocking and passing — as well as inviting and withstanding incredible amounts of physical abuse and pain — all for the benefit of people they quite likely have never met and never will. Neither football nor politics builds character. But they both eliminate weak ones.

New York Congressman and former NFL quarterback Jack Kemp has commented on the similarities. Kemp says: "Pro football gave me a good sense of perspective to enter politics. I'd already been booed, cheered, cut, sold, traded and hung in effigy."

Most important, success in both the football and the political arenas depends on a combination of leadership and teamwork. I always look forward to meeting and to talking with the members of this group, but especially so when important issues appear to be nearing resolution, as they are now in the Congress.

I've been asked to talk on banking legislation — and I plan to say a few words on that subject — but first I want to discuss a matter of growing concern to me which I hope may also be a matter of concern to you. I bring it up because I hope this meeting this morning can provide a forum for discussion. I hope that what I have to say will prompt some reaction from you. I hope you will tell me whether you share my perception — and my concern. And if you do, what you think can be done about it. I speak as a friend of banking — and certainly as a friend of the institutions represented here. And I want you to consider what I have to say in the spirit of constructive exchange.

As something of a lay historian when it comes to banking in this country, I've often been struck by the way bankers throughout the years have recognized how important the health of the banking system itself is to the well-being of their individual institutions.

That's not to say that there haven't been divisions in the industry — and that divisions don't exist today. Until re-

cently, one such division was between state-chartered and federally chartered institutions, though it appears that this split has been relegated to footnotes in history texts. Another division is that between small, independent banks and institutions such as those you represent — and this split — like the poor — seems destined to be with us always. And there have been — and are — regional divisions. These seem to be fading fast — though not as quickly as some wish.

You would have to be entirely naive to believe that these and other divisions didn't exist in the past — and that some don't carry at least some force today. There has never been — and likely never will be — a time when bankers were one big happy family. But that being said, even when you take these differences into account, bankers, in general, have sought to find common ground when they had to deal with critical threats to, or flaws in, the banking system as a whole. And they have done so — not out of a spirit of patriotism or public interest — but out of self-interest: A recognition that what was good for the banking system was good for the bank — and what was bad for the system was bad for the bank.

Certainly banks — as individual institutions — have competed with each other — sometimes relatively aggressively. Certainly, one group of banks has tried — and often succeeded — in manipulating public policy to maintain or to gain a competitive edge over other groups. But in this competition — market, political, or otherwise — bankers have restrained themselves from crossing an undrawn but universally recognized boundary.

American bankers in modern times have never used critical threats to the system as a competitive weapon against other banks. What has accounted for this remarkable feeling among bankers that — while they were not all in the same boat — they were in the same water?

Perhaps it was because the payments system provided the ties that bound the system together. Perhaps it was the phenomenon of correspondent banking. Perhaps it was the regulatory structure. Perhaps it was a defensive response among bankers arising from popular distrust for the banking community at large. Perhaps it was the combination of all the factors — and others.

Whatever accounted for it — this recognition among bankers that the system itself was important, it was fortunate — because it created a sense of community, a sense of common purpose, that allowed bankers on many occasions to achieve what needed to be done.

Now what has me — and other people in the public policy arena and elsewhere — concerned are nagging indications that this sense of community — this sense of common purpose built on the recognition that the well-being of the system is essential — may be in danger of crumbling. Crumbling at the worst possible time. Crumbling when more than ever, it is important for bankers to work together as a community to resolve several problems: Attaining the freedom for banks to compete in a hostile environment. Removing the pressure on the global economy from LDC credits. Weathering the slow recovery from economic downturns that have plagued America's heartland.

It will take time to work our way out of each of these problems. But, much time has already passed and people, including bankers, are growing impatient. This impatience, I believe, arises from the pressure to react to short-term market judgments. With the evolution of the banking — or financial services — business, bankers have come to be bottom-line business people, rather than trustees of depositors' funds with unique fiduciary duties, as was the case in the past.

Market analysts, investors, and others treat bankers as bottom-line business people and banks as bottom-line businesses.

This transformation was inevitable, given the massive changes in the financial world. But this transformation — while inevitable — cannot be total — at least in the minds of the bankers. What all of us have to keep in mind is that banks are in one vital respect not the same as, say computer manufacturers and other widget-makers. Banks are kept afloat on confidence. When a manufacturer gets into trouble, the other firms in the industry may very well benefit. When a bank such as those represented here today gets into trouble, others are likely to get hit with the fear that they suffer from its problem, too.

Thus, bankers have the very difficult task of maintaining balance — balancing short-term pressures with long-term needs — balancing the immediate advantage to their individual institutions with the long-term interests of the system.

I would like to touch on two problem areas where the balance may soon be — if it is not already — in danger of breaking down.

Six years of lobbying on banking's competitive opportunity agenda with nothing enacted but a moratorium has led to rising frustration in the banking industry — and to bank regulators. If there ever was a bottom-line political issue for the industry, it is this one. It is no secret that not all banks would benefit from each item in that agenda equally. But almost all banks, I believe, would benefit

when that agenda is enacted as a whole and the banking system would be strengthened.

The beauty of the conceptual approach now pending in Congress is that — rather than augmenting bank powers gradually — individual banks would be granted the flexibility to operate in the marketplace as their management sees fit.

Now — given the fatigue that six years of effort brings — some have talked of dropping the push for banking's agenda at the federal level. Let the moratorium expire, they reason, and we can go back to how things were before — a sortie against restrictions here, a sortie against restrictions there, small advances achieved in the states, in the courts and, yes, even in the federal regulatory agencies. Over the course of time, the theory goes, these actions together will take banking to where bankers want to go.

Well, as I remember it, recent years past were not exactly a Golden Age for innovation and achievement in that respect.

How long did it take the federal regulators to deregulate deposit interest rates even under Congressional orders to do so? Years.

How long did it take to convince Federal regulators to accept the principle that asset deregulation must come? Years.

And then when the regulators do more to deregulate, how long does it take to fight legal challenges to those actions in the courts — inevitable challenges given what is at stake? Years.

And even if it works, will this approach result in a logical legal framework? Has it so far? Does this approach make sense? No.

Yet, some banks would benefit, undoubtedly, in the short term if this approach is followed — while the system, as a whole, would continue to weaken. And therein lies the problem.

Only through common effort will banks achieve what all bankers need — federal legislation that would clear the decks and allow all banks the freedom to compete — change that rises above redrawing industry lines at the margin.

For the good of the system in the long run — a system that affects the fortune of every institution within it — bankers cannot allow themselves to be distracted by any other prospect. Indications that some bankers think differently is a cause for concern. Serious as these indications are, they are overshadowed by those elsewhere.

Over the last months we have seen what may be the sense of responsibility for the welfare of the system as a whole evaporating from the heat of the LDC debt management. In the short term, this problem plagues a smaller number of banks than does the need for legislation. But the shape of its ultimate resolution will long affect the banking system — and thus every bank that is a part of that system.

Again, for six long years the banking industry has sought a resolution of this issue. And bankers have sought a resolution together. Quite simply, you had to. It was a problem too big for any bank to handle alone. But, looking forward over the last year to more of the same, some bankers got the "Seven Year Itch." The itch to get out. The old cliché the negotiations ran under was: "We've got to keep the ball in the air." It appears that the new cliché for some is: "Let's punt and get out of here."

And some people suspect that — for a few — the decision to start exiting the field is driven, in part, by the knowledge that retreating now will give them an advantage over their old teammates when they meet them again as competitors on another field. In other words, beggar thy neighbor.

Now I am not totally naive. I don't expect any banker to stay at the negotiating table on banking legislation, on LDC debt, on any issue, out of a sense of altruism. And if there was ever a "club" for banking — a cartel where bankers met and divided markets to ensure competitive peace — the bankers here today were never a part of it.

Competition in a tough environment has always been a part of your business lives — though we all know how much tougher your environment has grown in recent years. And we all know that that competition always included competition against each other.

But — being a friend of banking and a conservative fellow — I believe what has worked to banking's benefit in the past should be preserved for banking's benefit in the future. Working together on the critical threats to and the flows of the banking system may cost your individual institution something in relative terms in the short term. But those threats and flaws — if allowed to spin out of control — will certainly cost all of your institutions absolutely in the long run.

Being tough, assertive, aggressive, certainly has its place in the hostile world in which you operate. But that doesn't mean that, to survive, bankers must prey on their own species.

In the end, what I am suggesting is that bankers maintain their sense of perspective in a chaotic world, that bankers continue to rely on their traditional institutional vision to chart their way in a time of flux. In the end, this institutional vision will prove to be your strength, not your handicap.

Several years ago in a speech addressing how the mass media contribute to a feeling of widespread gloom, Walter Wriston noted: "Not every battle is Armageddon." Not every problem is a crisis. Not every short term setback ushers in a long Dark Age.

To that I would add: Not every battle is Armageddon — unless someone wants it to be. Don't concentrate all your thinking on the problems of the next quarter — take into account how your actions then will affect you in the next decade.

With any luck, we'll all make it there — a fact worth keeping in mind.

Statement of Emory W. Rushton, Deputy Comptroller of the Currency for Multinational Banking, before the House Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, Washington, D.C., February 3, 1988

I am pleased to appear before the Subcommittee today strictly as a technical witness to discuss Continental Illinois National Bank and Trust Company of Chicago (Continental Bank) and its subsidiary, First Options of Chicago, Inc. (First Options). In my capacity as the Deputy Comptroller for Multinational Banking, I am responsible

for the supervision and financial analysis of the largest national banks, including Continental Bank.

As requested in the Subcommittee's letter of invitation I will cover the following (1) conversations I had with Continental Bank officials during the week of October 19

1987. (2) the position of the Office of the Comptroller of the Currency, (the Comptroller's Office) on the initial purchase of First Options by Continental Bank; (3) the efforts of the Comptroller's Office to monitor the terms of the purchase and (4) the actions taken by the Comptroller's Office to assure that future capital infusions conform to the restrictions we placed on Continental Bank as a condition of approving the purchase.

First I will address the bank's initial purchase of First Options, and will turn then to the other questions in the Chairman's letter.

Initial Purchase of First Options

The Comptroller's Office approved Continental Bank's proposal to purchase First Options, and operate it as a subsidiary, in December 1986. The approval came only after the Office had thoroughly reviewed the legal questions and the risks involved. Our approval covered activities that were legally permissible for a national bank to engage in directly. These primarily included extending credit, and performing transactional execution and clearing services. The Office was also satisfied that Continental Bank would have adequate controls over the possible risk associated with its ownership of First Options. Among the factors considered in reaching this determination were First Options' own internal control systems and the talent and experience of senior management of First Options.

The Comptroller's Office and the FDIC, which is Continental's largest shareholder, viewed the acquisition not only as a legitimate business for an operating subsidiary of a national bank, but as an opportunity to enhance the institution's earnings and market value, and thereby enhance the government's ability to return the bank to private ownership as quickly as possible.

The Federal Reserve Board also participated to the extent that it approved Continental's acquisition of First Options' London operation, which came under its jurisdiction.

Under existing law and regulations, there was no limit on the amount of financial support that Continental Bank could have given First Options as an operating subsidiary of the bank. However, due primarily to the significant size and importance of First Options in its industry, the Comptroller's Office, as a precautionary move, imposed certain restrictions on the financial relationship between First Options and the bank as a condition of the approval to acquire First Options. These restrictions included a limit on the bank's total investment in, and loans to, First Options to an amount that would not exceed what the bank could lend legally to an unaffiliated customer, as opposed to the unlimited amount it could lend legally to

an operating subsidiary. As a standard rule of law, a national bank such as Continental could lend an amount equal to 15 percent of its capital to any borrower on an unsecured basis, plus an additional 10 percent of its capital, if the additional 10 percent was fully secured by readily marketable collateral. Because of the inclusion of these restrictions, the Comptroller's Office believed that the bank would be adequately insulated in the event First Options should suffer extraordinary financial losses.

Specifically, this meant that during the week of October 19, 1987, Continental Bank could invest in, or lend to First Options on an unsecured basis, approximately \$381 million, plus an additional amount of about \$254 million, if that additional amount were properly secured. Prior to that week, the bank had remained within the limits. It was the unsecured limit that the bank exceeded during the week of October 19, 1987. It was also this issue that prompted numerous telephone conversations between bank officials and representatives of the Comptroller's Office, including myself, and that led to our taking formal enforcement action against the bank the following Monday, October 26, 1987.

Conversations During the Week of October 19, 1987

My first telephone discussion with Continental Bank officials following the market collapse on Monday, October 19, 1987, occurred at about 9:30 p.m. Eastern Time that evening when I returned a call to Continental's Executive Vice President Bill Gunlicks, at his home. (Mr. Gunlicks was the Continental Bank officer to whom First Options reported.) Shortly before that, I had received a call at my home from one of our field examiners who said that he also had been called by Mr. Gunlicks that evening, and that he had referred Mr. Gunlicks to me.

Mr. Gunlicks began the conversation by saying that First Options had remained in business during the day, and that the bank had stayed within, but was approaching, the unsecured lending and investment limits that were contained in our original approval. He described the day's trading activity as chaotic, and said that there were serious back-logs in pricing positions. He said that attempts would resume at 4:00 a.m. the next morning to determine the amount of losses resulting from customers who could not meet their obligations to First Options, which he estimated at possibly \$30-\$50 million. He also indicated that he would not know until the next day the amount of additional capital requirements that would be required of First Options. I told Mr. Gunlicks to keep us informed as more information became available.

The next morning, Tuesday, October 20, I began alerting other senior officials of the Comptroller's Office that a potential problem was developing at First Options that might require our involvement. Various senior members

of our office were present during most of the conversations I had with bank officials the remainder of the day.

Early that afternoon, I received another call from Mr. Gunlicks. He advised me that independent vendors who priced securities were still behind schedule due to the heavy volume on the previous day, and that First Options' staff had been trying to establish prices manually since early that morning. He said the prices ultimately would affect First Options' capital requirements, and that he expected First Options would need additional capital that day. I told Mr. Gunlicks that we were not prepared to waive or increase the limits contained in our original approval. Mr. Gunlicks sounded as if he were under a great deal of pressure and was inconclusive as to what the bank might do if there actually turned out to be a capital shortfall at First Options that day.

Following that conversation, I discussed the matter with various senior officials of the Comptroller's Office, who agreed that we should not waive or increase the limit. We also agreed that we should caution other officials of the bank that our limits must not be exceeded, in light of Mr. Gunlicks' unclear position.

I then called Continental's General Counsel, and advised him that we were disturbed about the situation as Mr. Gunlicks had described it. I told the bank's General Counsel that the bank must not exceed the limits, and that any additional capital required by First Options should be obtained from other sources, including, if necessary, the bank's holding company, Continental Illinois Corporation. He professed a lack of knowledge of the subject, but promised to inquire immediately and call me back.

The bank's General Counsel called me back at about 4:00 p.m. Eastern Time, and said he had found out that there might not be a problem after all, because the bank believed it was appropriate to revise the method used to calculate the limits on the bank's investment in, and loans to First Options. He did not seem entirely clear about the revised calculations, but indicated that they involved a change in the way the bank had been viewing its equity investment in First Options. He said he understood that Mr. Gunlicks, along with our on-site examiner, would be calling me shortly thereafter to discuss the matter further. At that point in the day, we still had not been provided with any real or estimated amounts of additional capital that First Options might need.

I then called our on-site examiner who said that earlier in the day, he had personally rejected the bank's proposal to revise its calculations, and had so informed Mr. Gunlicks. According to the examiner, the bank's revised calculations were based simply on the notion that the bank's limit to First Options should be a total of 25 percent of

the bank's capital, i.e., 15 percent unsecured, plus an extra 10 percent secured, regardless of whether there was proper collateral for the extra 10 percent. Under such a theory, which we rejected, the bank could have made unsecured loans to First Options, without regard to whether the total unsecured loans and investment exceeded the 15 percent unsecured limit. I told the examiner that senior management of the Comptroller's Office agreed with this rejection of the bank's revised calculations, and that he should likewise inform bank management of this fact. The examiner later told me that he had then informed Mr. Gunlicks, at about 3:30 p.m. Chicago Time, one-half hour before settlements for that day would be required, that his (the examiner's) original position had since been confirmed with the Washington Office.

Shortly after 5:00 p.m. Eastern Time, I received a joint call from Mr. Gunlicks and our on-site examiner. Mr. Gunlicks began the conversation by describing the general chaos of the past two days, and the need for additional capital support to First Options. He attempted to advance the revised calculation theory which I just described. I told Mr. Gunlicks that a national bank's legal lending limit, on which our original approval was conditioned, was 15 percent of the bank's capital, and that the additional 10 percent limit was available only if it was fully secured by readily marketable collateral, which the bank's investment in First Options was not.

At about this point in the conversation, Mr. Gunlicks' description of events changed from the present tense to the past tense, when he said for the first time that the bank had, within the last half-hour, already made an additional, unsecured advance of about \$130 million to enable First Options to meet its estimated capital requirements. This advance, when combined with the bank's unsecured advances already outstanding, plus the unsecured equity investment, exceeded the unsecured limit by about \$128 million. Apparently, the decision to make the extra advance was reached shortly after the examiner had informed Mr. Gunlicks that it was the official position of the Comptroller's Office that the bank's theory was not acceptable. Mr. Gunlicks told me that the decision to make the additional advance had been a "reasoned business decision" based on the exigencies of the moment, and that it had been approved by senior management of Continental.

I told Mr. Gunlicks that we considered the \$130 million advance to be a violation of the limits imposed in our original approval, and that the bank must not make any further advances which would aggravate the situation. I also told him that we would have to consider appropriate remedial action and that we would be back in touch with them shortly.

Following that conversation, we prepared documents which would force immediate correction of the violation in the event that the bank refused to do so.

Later that evening, I received a call from the bank's General Counsel informing me that, upon the advice of their outside counsel, the bank's loan to First Options that exceeded the limit would be corrected the next morning by a direct loan to First Options from the bank's holding company.

I recommended that the Federal Reserve Board be informed of this plan, as the Federal Reserve is the primary regulator of the holding company. Shortly after that conversation, I spoke with a senior official of the Federal Reserve Board in Washington, D.C. to describe what had happened, and to alert them that Continental probably would be calling them regarding the holding company advancing money to First Options.

The next morning, the bank's General Counsel called me to confirm that the bank's excessive loan to First Options had been repaid by a loan from the holding company. He also indicated that they would be discussing the matter with the Federal Reserve Board that morning.

Subsequent Events

Notwithstanding the bank's quick action to remedy the violation, the Comptroller's Office considered it necessary and appropriate to take formal enforcement action against Continental to ensure that in the future the bank observed the restrictions contained in our original approval.

Therefore, on the following Monday, October 26, 1987, representatives of the Comptroller's Office attended a meeting of Continental's Board of Directors in Chicago and described to them the seriousness of the violation that had occurred. At that meeting, each Director signed

and agreed to the entry of a formal corrective Order.

With this Order in place, any further violation of the terms and conditions of the original approval can be immediately enforced in a federal district court. Further, as a result of having this Order in place, civil money penalties can be assessed against the bank and its directors for any violation of the Order. The Order also requires the development of a formal contingency plan, acceptable to the Comptroller, designed to avoid a repeat of the funding problem experienced during the week of October 19, 1987.

Since the bank's acquisition of First Options slightly more than a year ago, the Comptroller's Office has been monitoring compliance with the terms of the original approval through on-site examinations and other communications with bank management — and we will continue to do so.

Finally, we believe there are practical solutions that can be applied if, in the future, First Options should need additional capital support in excess of the limits in the original approval. For example, recently the bank requested our permission to increase its equity investment in First Options to enable First Options to meet certain equity requirements of the SEC and the exchanges. We did not approve that request because we were not prepared to let the bank increase its equity investment in First Options. As an alternative, we suggested that the bank's parent holding company could contribute the new equity either directly to First Options, or indirectly to First Options through the bank. This was accomplished several weeks ago. It illustrates one way that the Continental organization can support First Options without increasing the net exposure to the bank's capital and deposits.

Mr. Chairman, this concludes my prepared remarks. As agreed, I will be happy to respond to any technical questions you or the other members may have.

Remarks by Robert L. Clarke, Comptroller of the Currency, before the ABA National Trust and Financial Services Conference, Washington, D.C., February 22, 1988

Several years ago, I was in a small town in West Texas on business and I caught a live interview on the late night local television news with one of the town's residents. The interview was on the occasion of the 50th anniversary of the man's graduation from Texas A&M University. You know, not much happens in those small towns. The reporter asked the man what he believed to be the most

important invention since his graduation. "Well," he said, "the thermos bottle." "The thermos bottle," the reporter repeated, "How can you say that when in the last 50 years we've fought a World War, found a cure for polio, put a man on the moon. . . What's so great about the thermos bottle?" "Well," said the man, "it keeps hot food hot and cold food cold." "Yes," said the reporter, "we

know — but what's so great about that?" "How does it know?" the man said, "HOW DOES IT KNOW?"

Certainly, the last few years, if not the last 50, have brought many changes — innovations, technological developments — to the trust part of the banking industry. But the biggest change hasn't been in technology or product expansion, though those are often discussed as moving forces within the trust business. The biggest change has occurred in the minds of trust bankers — a revolution in thinking — a change in perspective.

You always offered a unique service to the public. Over the last ten years, you've learned to market that service too. And you learned to do so for one very important reason: Survival.

Nearly a decade ago — in his study *Marketing Myopia in the Trust Business*, Professor Theodore Levitt warned that to survive, trust bankers such as yourselves would have to revolutionize your thinking.

That study was followed by the two *Synergy in Banking* reports and *The Retail Force* — roadmaps to the future for banking in general and trust banking in particular. The evidence of your success is there for anyone to see. For example, I recently noted that in one state alone — California — assets at trust units more than doubled from 1982 through 1986. You don't accomplish that kind of record by waiting for clients to walk through the door. To generate that kind of business, you go for it.

One of my college friends back in Texas is a trust banker and his wife says his transformation to marketer is nothing short of astounding. The last time we were home, she told me that he has become such a dedicated salesman that he has subscribed to this wonderful new magazine just to learn how to be more dynamic, more aggressive, and more of a go-getter. Always looking for new marketing ideas, I asked her if she had ever read the magazine and she said, "No, but I can tell what it's about by the title." "What is it?" I asked. "*Hustler*," she replied.

A sales orientation is certainly a part of successful marketing — but as we all know, that's not all there is to it.

Marketing — as Sheshunoff & Company once defined it — is the function charged with converting corporate objectives into bottom-line reality. As you all know, there are several essential steps in marketing:

1. Determining the desired customer base.
2. Identifying the needs of the customer.
3. Creating benefits that will satisfy the needs of the customer.

4. Communicating these benefits to the customer

5. Following up to answer any question from the customer.

Successful marketing people think in terms of benefits — not selling products and services. And successful marketing people have a thorough knowledge and understanding of the features and benefits of whatever they are marketing.

I've gone into marketing theory in such detail today — not because I want to give Professor Levitt and other marketing experts a run for their money — but because it is relevant to what you are in Washington to do. Tomorrow afternoon, you will go to Capitol Hill to market your vision of banking's future in a crucial marketplace of ideas — the Congress.

That vision is reflected — in concept — in a product: legislation now being designed by the Senate Banking Committee, legislation sponsored by Chairman Proxmire and Senator Garn. In part, that legislation seeks to balance benefits that banks would receive from performing wider securities activities with both customer protection — the domain of the SEC — and bank safety and soundness — the preserve of the federal bank supervisors.

As I said, that legislation is still in the design stage. As it is refined — and refined again — its authors will analyze it carefully for unintended consequences. But if you have followed its genesis and development as closely as I have, you know that it is a complex package. So I urge you, too, to analyze its provisions carefully, especially the new provisions on the regulatory structure that would support wider securities activities. Because you will have to live with it if it is enacted, you have an obligation to know what is in the bill and to participate in its refinement. If, in your analysis, you find problems, make your views known.

That being said, the good news remains that you may soon have a product — legislation that embodies your visions of what banks should be. You must market that product to the entire Congress. The 535 individuals who make up the U.S. Congress are among the toughest customers you will ever face. All you have to do is ask the current Administration — as well as bank supervisors and your industry representatives.

We have been trying to sell the Congress on expanding the business of banking for the past seven years. I don't have to describe for you how the campaign has gone — or its results. I do, however, want to stress that our collective efforts in the past have not been totally without result. In fact, because of our collective efforts, today there is a recognition — in the media, in the academic world,

and among many members of Congress — that change must come. The outstanding questions are “How much?” “When?” and “In what form?” For you to be successful in marketing your vision of banking’s future to the Congress, you will have to think strategically.

You will have to identify the wants and needs of the legislators and to talk about how the benefits in your plan will meet their needs. Not how it will meet your needs. But how it will meet their needs.

What do the 535 individuals who make up the Congress want? They want their constituents to be happy. And they want a safe and stable financial system.

You are well primed to talk about the benefits of expanding the banking business for the customer — how doing so would make individual constituents happier.

Fortunately, as trust bankers, you also have a special credibility that reinforces what you say when you talk about why expansion of the traditional business of banking — as embodied in pending legislation — would be no threat to safety and stability. That credibility arises from your background as fiduciaries.

As fiduciaries, you can credibly argue that bankers can successfully handle conflict-of-interest situations that might arise from an expansion of the business of banking. Why? Because you handle them now. As fiduciaries, you can credibly argue that bankers can successfully avoid self-dealing if the business of banking is expanded. Why? Because you manage to avoid it now. As fiduciaries, you can credibly argue that the concept of the so-called fire wall can successfully be applied to an expansion of the business of banking. Why? Because you work on one side of a much less formalized Chinese Wall each and every business day and it works for you.

Furthermore, you can state that you indeed recognize and accept that new legislation will bring with it new standards on conflict-of-interest and self-dealing — some additional fiduciary responsibility. But you can also underscore that these standards can be structured to be a part of a fire wall built between banking and affiliates — and that the whole purpose of a fire wall is to prevent the spread of damage should an accident occur.

At the same time, you can stress that — the way the legislation is now structured — most new bank securities activities would come under the regulatory oversight of the SEC. Why is this significant? Securities activities that have been successfully supervised by the SEC when conducted by investment bankers would be supervised by the SEC when these activities are conducted by bank affiliates.

That is important — a fact that should answer many

doubts the legislators may have. I really cannot overstress the importance your special credibility will have when you promote your vision of banking’s future on Capitol Hill tomorrow.

Just as personal selling is the most effective form of promotion in the marketplace for goods and services, personal selling is the most effective form of promotion in the marketplace for ideas.

And for the same reason: It allows you to tailor your presentation to the individual prospects. It allows you to answer their questions. It allows you to handle their objections. It allows you to ask for a commitment — which in the marketing world is called closing the sale.

And it will allow you to follow up later personally — if the prospect isn’t willing to make a commitment on the spot or if further questions or objections arise.

For many of you, it may not be enough to simply communicate your message — you may likely find yourselves talking to your legislators again. As any salesman will tell you, following up is important. That advice wasn’t lost on a young life insurance salesman not too long ago. This fellow had the worst sales record in his entire company. And to make it worse, the salesman with the best record worked out of the same regional office. One afternoon, the young salesman walked into the superstar’s personal office and said: “Listen, you never seem to miss a sale and I never seem to make one. What’s the secret of your success — doesn’t anyone ever turn you down?” And the superstar said: “Son, it happens all the time.” “But”, said the young salesman, “you always seem to sell them a life insurance policy eventually.” “Most of the time, the next day,” said the superstar. “How do you do it?” the young insurance salesman asked again. “Well,” the superstar said, “I send their wives a nice floral arrangement anonymously, and enclose the card: With sympathy on your bereavement.” Don’t waste your effort tomorrow — if you don’t get a commitment then, follow up.

When you make your rounds tomorrow, you will hear a number of creative objections being raised by your opponents. Most of these objections were created for purely anti-competitive reasons and most are red herrings. You will hear: “Bankers can’t deal with conflict of interest.” But again, point out that trust bankers do so every business day. You will hear: “Bankers can’t handle the securities business.” But point out that trust bankers do so every business day. You will hear: “Bank supervisors can’t deal with securities regulation.” But point out that we have done so for decades — and point out, again, that most new securities opportunities for banks would, under the proposed legislation, be conducted in separate affiliates supervised by the SEC. And you will hear — again and again — the reddest of red herrings: “First Options is a

clear example of how banks cannot handle being involved in the securities business.”

You will remember the facts. Continental Illinois acquired First Options. As a condition of our approving the acquisition, the bank could not lend any more to First Options than it could to any unaffiliated customer. In other words, we set out traditional lending limit on transactions between the two. On October 19, First Options needed additional funding — and Continental Illinois supplied it in violation of our condition. The bank thought better of its action later and corrected the problem within 12 hours. The simple answer to the objection many will raise is that First Options had no direct implications for expanded securities authority. First Options was not in the securities business. First Options is in the financing business.

First Options could not have been acquired by Continental if it had the authority to do anything that Continental Illinois itself was not authorized to do. Another way of saying it is that Continental Illinois could have performed the services First Options performed — within the bank itself — without affiliating with the company. Its violation of the lending limit was no different than any other bank violating its lending limit. And we dealt with it in the same manner as we would deal with any lending limit violation by any other bank. You cannot make that point too strongly.

I would just like to conclude today by pointing out that — to get your message across tomorrow — you will need drive — selling — and effective selling — the kind of selling best exemplified by a young Catholic friend of mine named Mary.

Mary was in love with John and he in love with her — but John was a Baptist and had trouble with the idea of marrying outside of his Church.

One day Mary, in tears, went to her mother and asked what she should do. Her mother answered: “John’s an intelligent man — use some salesmanship. Just sit down and talk to him about our great Church. Explain to him about its long history, about its great beliefs and the great martyrs and noble saints and the wonderful cathedrals and the beauty of its services. Now, go out and give him a good selling job.” Mary dried her eyes and went out to see him. Later that night she returned home — in tears. Her mother, comforting her, asked, “What’s the matter? Didn’t you sell him?” And Mary replied: “Sell him, SELL HIM . . . Sure I sold him . . . and now he’s going to become a priest.”

Show that kind of salesmanship tomorrow and you, too, may make a true believer out of someone.

Remarks by Robert L. Clarke, Comptroller of the Currency, before the National Council of Savings Institutions Government Affairs Roundtable, Washington, D.C., February 24, 1988

I always look forward to speaking before thrift executives, and especially before a progressive group such as this one here today.

One of the best things about working in Washington is that you are constantly surrounded by reminders of the nation’s past. While driving past the Federal Reserve Building not too long ago, I recalled just how partisan and passionate banking politics was in the early history of our country.

As our young nation grew, a fierce rivalry developed among various financial institutions. Sometimes this rivalry grew deadly.

I’m sure you’re all familiar with the debate in the 1830s over the Second Bank of the United States, known among its opponents as Biddle’s Bank after its head, Nicholas Biddle. At that time, Biddle’s brother, then a bank branch

manager in St. Louis, killed a local competitor in a pistol duel at five paces. Setting a pattern for future debate within the industry, Mr. Biddle also fell mortally wounded.

A fierce rivalry has also marked the relationship between commercial banks and thrift institutions over at least the last two decades or so — and still does. But while we can debate the need for two separate types of institutions — and two different types of supervision for them — I think we all do recognize that commercial banks and thrifts together comprise a distinct industry: the insured-depository institution industry.

While commercial banks and thrifts are not in the same boat, both types of institutions are treading in the same water. They face many common problems — the competitive challenge from nondepository financial institutions, the need for adequate capital, and the need for knowledgeable and diligent directors, just to name three

And — I cannot be said too often — they both float on the same sea of public confidence — public confidence that goes a long way in explaining the \$11.7 billion gain in thrift deposits in the fourth quarter that the Federal Home Loan Bank Board reported — the first fourth-quarter gain since 1984. So today I would like to touch on a few issues of importance to both commercial banks and thrifts.

As far as FDIC-insured institutions are concerned, we have a pretty good idea of what the price of public confidence is. About \$18 billion. In other words, the total assets in the FDIC insurance fund. This \$18 billion is the reserve that backs up the belief in circulation among the public that the money they deposit in banking system is safe and sound.

For FSLIC-insured institutions, the price of public confidence is the special insurance assessment many of your institutions pay on top of your regular premiums. And the future is unclear as to whether that price will rise. If it does, a question that has cooled down the last few months will certainly heat up again: the question of merging the two insurance funds. As a member of the FDIC board of directors, I am opposed to such a merger for three reasons. The first is simple and short. Banks have problems. Savings and loan associations have problems. Mixing these problems together into one big problem doesn't make much sense to me.

The second reason, admittedly, is a value-judgment on my part. I think a merger would be unfair to the institutions that have built-up the FDIC fund. In a way, it would place them in a position not unlike that of a shareholder in mutual insurance company established to insure farm property in the Midwest against cyclones who woke up one day to find the company had to take on covering Los Angeles for earthquakes, too. What a shock!

In addition to these two reasons, the third, I believe, nails the case against a merger shut. It wouldn't solve the S&L problem. Even the most conservative estimate of the money it would take to solve that problem is more than what is in the FDIC's coffers today. Furthermore, say the FDIC fund was drained to cover the S&Ls, nothing would be left to address future problems.

And — as you know, FDIC-insured institutions are having their problems, too — last week there were 1,541 banks on the problem list, although that's better than the 1,657 that were listed last June.

Indeed, last year the FDIC's income was just about equal to its outgo — the agency was in the black by only \$50 million for its income for the year. Expenses last year were about \$33 billion.

It could have been worse had not the FDIC begun taking a creative approach to dealing with failures: open bank assistance transactions (19 last year) — whole bank transactions — that transfer the responsibility of dealing with a bank's bad assets to the private sector.

Indeed, FDIC Chairman Seidman estimates that if the agency had not embarked on its creative approaches, the assets under liquidation would have soared and the agency's cash reserve could have shrunk from its current level of \$16 billion to \$10 billion.

Bank failures in 1987 — 184 in all — were about one-third higher than in 1986, but these creative solutions kept the level of new assets to be liquidated at about the same level both years. So far this year there have been 28 bank failures and 6 assistance transactions. At this time last year, there were 31 and 2.

These creative solutions are significant for several reasons other than the fact they are more efficient for the FDIC to pursue than straight bad asset liquidations. They allow assets and bank services to remain in local communities. They allow bankers to work with problem customers. And they allow the bank-customer relationship to continue. Thus they benefit the agency, the community and the customer.

The FDIC's record is impressive. But it is essentially a record of damage control.

The third — and final — item I want to touch on today is our effort to change the law so that damage may be avoided in the future. I mentioned the special insurance assessment that thrifts have had to pay on top of their regular premiums. FDIC-insured institutions have also seen their premiums rise, in effect, because in recent years the agency has stopped giving rebates.

Both of these cost increases are clear warning signs that reforms in our financial structure are necessary, that depository institutions need greater profitability and the only way to achieve that great profitability is through new competitive opportunities. And that means legislation — legislation especially that the Senate Banking Committee is designing under the sponsorship of Chairman Proxmire and Senator Garn.

Over the past several weeks, I believe we have made substantial progress preparing the way for that legislation's passage. We have structured a regulatory framework that balances benefits that banks would receive from performing wider securities activities with both customer protection — the domain of the SEC — and bank safety and soundness — the preserve of the federal bank supervisors. Banking has coalesced in support of the legislation about as well as bankers as a group can agree on anything.

We've seen two committee prints — with another on the way. And a markup is scheduled. We have a bill cranking along that looks O.K. — if we can guard against it being garbaged up later in the process.

In short, I am optimistic, though I am aware of Ambrose Bierce's definition of optimism: "A blind faith that is inaccessible to the light of disproof — it is rarely contagious."

Later today, you will discuss among yourselves the posi-

tion the Council should take on the future of the FSLIC and the FDIC. First, I hope you decide that we should have one. Second, I hope you arrive at the position we should both have one separately.

The FDIC has its strengths — both financial in terms of assets and managerial in terms of executive talent and innovative thinking. With luck it can grow only stronger and better. And luck comes to those who prepare for it

Remarks by Robert L. Clarke, Comptroller of the Currency, before the ABA National Conference for Community Bankers, Los Angeles, California, February 27, 1988

When John Berg asked me to address this conference, I told him I would consider it a pleasure to do so and reminded him that — as a government official — I could accept no honorarium for speaking. "That shouldn't affect the quality of your speech," John said. But I told him: "John, don't be so hasty."

Many years ago, I said, there was a priest who was asked by a very poor family to conduct a funeral service. "We have very little money," they told him. "How much will a funeral cost?" "Well," said the priest, "I can give you a \$10 service, a \$6 service, \$4 service, or a 50-cent service. Or I could do it for free." "Ten dollars is too much for us to pay, but what's the service like?" asked the family. "Oh," said the priest, "It's a great service, very sad. Everybody in the room will cry. And I cry too." "What about the \$6 service?" asked the family, "we have so little money." "Ah," said the priest, "that's very good, too. Everyone in the room will cry, but I don't." "And what's the \$4 service like?" asked the family. "It's a fine service, a very good service," answers the priests. "Half of the people in the room will cry, and the other half won't." "We're so very poor," said the family. "What's the 50-cent service like?" "Oh," said the priest, "It's a great service, a wonderful service. Half the people will cry and the other half laugh." "And if you do it for free?" the family asked. The priest replied: "Everybody laughs."

John, I'm doing this for free.

The point of that story is, of course, that you get what you pay for.

In the last several months, the banking industry, in general, and the ABA, in particular, have — in terms of time and effort — paid for a resumption of progress on banking's legislative agenda.

What are you going to get for that investment?

In just a few hours, the moratorium Congress imposed on federal bank supervisory approval of expanded competitive opportunities for banks is scheduled to end. As the sun sets on that statutory stricture Tuesday, the Senate Banking Committee is scheduled to consider legislation that would, in part, roll-back the Glass-Steagall Act. Now I am the last person in the world to try to predict what Congress will do, having personally watched it in action over the last 2 years.

The only forecast of Congressional activity I can make with any degree of certainty is this one: If the Lord's Prayer were introduced as legislation in the Congress of the United States, members would undoubtedly offer amendments and a conference committee would be called to iron out the differences between the House and the Senate.

That being said, it does appear to me that we can construct three scenarios of what the post-moratorium world might look like . . . And it appears to me that something like one of the three scenarios is likely to occur. One scenario is progressive. One is regressive. And one is marginal.

Or you can look at them as Frank Maguire (Senior Deputy Comptroller for Legislative and Public Affairs) does: the good, the bad and the ugly.

Interestingly, each scenario parallels my own experience in some way.

As a bank supervisor, I've worked — as have members of this association, including you, the progressive community bankers here today — for the progressive propo

ation that our laws must be changed to allow banks the competitive freedom to succeed — and thus survive.

As an attorney, I worked within a legal system based on precedent — the regressive concept that because something was decided in the past it should be imposed on the future — a notion akin to driving a car with your eyes firmly fixed on the rear view mirror.

And as a student of economics — a marginal science — in college, I was intellectually basted with marginal concepts: marginal cost, marginal utility, marginal productivity, and marginal propensities to consume, invest, and save, to name just a few.

So when Paul Volcker — an economist's economist — used to talk about "changes on the margin," I knew where he was coming from — incremental elaborations on the status quo.

What's the good scenario? Congress will pass legislation similar to what Chairman Proxmire and Senator Garn are sponsoring — legislation that will enable banks to evolve in line with market reality — legislation that will allow you to offer your customers mutual funds and to underwrite in municipal revenue bonds, among other things.

What's the bad scenario? It could come in several ways. Congress could try to reimpose the moratorium — in other words, club the bank supervisors back into cages where we have no freedom to act.

Or instead of using a club, the lawmakers might take a more sophisticated approach: Tacking provisions detrimental to the banking industry onto legislation that is intended to provide limited expansion of competitive opportunity somewhat. In other words, dancing the Capitol Hill three step — one step forward, two steps back. For example, by granting banks some securities powers while at the same time barring them from real estate and insurance opportunities. I would oppose that — actively and in person — just as I'm sure you would, too. Whatever way it might come, regression in any form would be bad public policy. It would be bad for the banking industry. And it would be bad for bank customers.

At worst, it would freeze banking now in hopes that someday a cure for the profitability disease that plagues banks might be found — even though the cure for that disease is being manufactured in the Congress' legislative laboratory today.

At best, it would allow the issue at hand to degenerate from a strategy of preparing banking for the future to a tactic of tacking a few powers onto the business.

Regression in any form is unacceptable. Once the regres-

sive genie is out of the bottle, banking's wishes might never come true. Look at how hard it has been to get anything done over the last 7 years.

Now that leaves us with the third scenario: what if the moratorium dies and no legislation is passed? In other words, a return to the status quo ante moratorium — the ugly. It is hardly the best of all possible worlds — but, at least in the short term — hardly the worst.

Without new federal legislation, banks would likely continue to gain — through enactment of new banking laws and regulations at the state level, through regulatory action at the federal level, and through court rulings — at the margin.

At the margin, some banks can already sell mutual funds and commercial papers, offer securities brokerage and advice and provide insurance and real estate services. At the margin, 23 of the 45 state legislatures in session this year have — or are expected to have — before them a proposal to allow banks to offer customers an expanded list of services. However, those proposals range widely in coverage, from relaxing branching restraints . . . to giving state-chartered banks the same powers granted to national banks in anticipation of Federal legislation . . . to legislation like that pending in Tennessee that would allow banks to offer full securities and insurance powers — except for underwriting — and more flexibility in the amount they can invest in real estate. And I would just like to note that, from the supervisory angle, there is only so much room for interpretation in the statutes — you can only go so far down that road.

At the margin — and for the short-term — maintaining the status quo ante moratorium isn't as bad as regressive legislation — the bad — but is far from as beneficial as good legislation would be. For the short term, it's not a bad way to mark time — but it's still only marking time. And gains — at the margin — are ultimately no solution to banking's problem.

Any banker who considered marginal gains to be a solution to banking's fundamental problem — competitive equity — would likely think that a new suit will satisfy his or her clothing needs for life. In fact — in the long run — gains at the margin will work only to make banking's problem worse.

I hate to use this terminology in L.A., but there was a time when a major fault ran through the membership of the ABA. It wasn't a split between large banks and small banks — or between profitable banks and poorly performing banks. It was a split between state-chartered and federally chartered banks. Indeed, the two types of institutions were considered to be so distinct as to have their own formal divisions within the ABA organization. That

partition has long since been erased — because the conditions underlying it were erased.

But if this industry — in the long term — settles for marginal gains — the steady but glacial erosion of competitive restraints — we may again see such a division arise.

Some state legislatures have already granted state-chartered banks more competitive opportunity than their national bank counterparts have. And, as the Comptroller of the Currency, that concerns me though not nearly as much as it will if the trend continues.

Why? Because actions at the state level that grant state-chartered banks marginal gains place national banks at an even greater competitive disadvantage — not only with nondepository financial institutions and thrifts — but also with their state-chartered counterparts.

Furthermore, in the long term, marginal gains would also create other separations within banking. Some states would move quickly and comprehensively in granting banks wider competitive opportunities. Others would not. And certainly bankers would come to see state legislation as a competitive edge to be used against their rivals — nonbank and bank. In its own way, that would be as regressive as any legislation the Congress could think up — and perhaps even more so. Indeed, it could return banking to a time when inter-industry warfare was deadly.

I'm all for the dual banking system — but not for a banking system in which bankers duel with other using laws and regulations as weapons.

Marginal competitive gains — if divided within the industry unequally — could very well lead to family feuds. As a matter of public policy, we should be seeking. . . Not to put some bankers ahead of others. . . Or give some bankers a kick in the head. But — in the long run — to put bankers on an equal footing with their nonbank competitors . . . To give banks the flexibility to innovate . . . Within a framework where everyone plays by the same rules . . . And consumers reap the benefits of the creative competition.

So where does that leave us? It all depends on your perspective — always an important consideration, as the Prophet Moses found out many years ago. You remem-

ber the story. Moses and his troops reached the Red Sea in flight from the Egyptians. With the Egyptian soldiers in hot pursuit, Moses had a real problem in how to cross the Red Sea. So he called a staff meeting and asked for solutions. He turned to the head of the army and said, "General what do you suggest?" The general replied, "Moses, we might be able to lay pontoons, but it would take at least 2 years." Moses then turned to his admiral. "Admiral," he asked, "what to you say?" "Well, Moses, if we had landing barges, we could do it, but it would take 6 months to build them." Then Moses looked over at his chief of engineers and asked him for suggestions. "Moses," he said, "we could build a bridge but that would take at least 3 years." At that point, the public relations man at the table raised his hand. Moses looked down at him and asked: "Okay, what's your solution?"

And the public relations guy answered: "Boss, I can't say you can do it, and I can't say you will do it, but if you can find a way to part that sucker and walk us through, I can get you two pages in the Old Testament."

I would just like to leave you with this thought as a backdrop against which to consider those decisions: Three experts — a lawyer, an economist and an English professor — were on one of those late night radio shows to talk about copyright legislation. The interviewer ran out of questions before he ran out of time, so he tossed out the question: "What book would you want to have if you were stranded on a desert island and why?"

The lawyer, surprised but accustomed to speaking without thinking, replied: "*When Bad Things Happen to Good People*, so I can reflect on my life and fate if conditions become dire." The economist, rational and practical, replied, "*The Air Force Survival Manual*, so I can eke out a marginal existence until I'm rescued." The English professor replied: "*Thomas Guide to Practical Shipbuilding*."

Where does banking legislative agenda go from here? The answer you choose depends on your perspective — whether it's narrow or wide-ranging. And on how you choose to view your predicament — whether you want to endure it or escape from it. Today I've described my perspective and my view of your predicament from where I stand.

Remarks by Robert L. Clarke, Comptroller of the Currency, before the Independent Bankers Association of America, Honolulu, Hawaii, March 15, 1988

A recent analysis in the *National Journal* concluded that the children's classic, *The Wonderful Wizard of Oz*, wasn't just a flight of imagination — it was a parable on how to deal with the problems of the times. When it was published in 1900, the nation had had almost a decade of economic troubles. These troubles had arisen as the U.S. economy was incorporated into the global marketplace. The technological revolution of the time had broken down the transportation and communications barriers that had previously isolated the U.S. from the world.

To many adults who read the book, Dorothy was the average small-town American who yearned to return to Kansas — the simpler, more secure world of her past. The scarecrow — who symbolized agriculture — needed a brain. The tin woodman — who represented industry — lacked a heart. And the lion — who stood for Wall Street — desired courage.

Off they trooped down the Yellow Brick Road to the Emerald City — Washington — in search of the Wizard of Oz — the federal government, who they thought would resolve their difficulties by magic. It was a shock when they discovered the great Oz could not simply give them what they wanted: protection against the rough-and-tumble world. But he gave them something more important: the realization that they had the power within themselves to solve their problems. They had the brains, the heart, the courage that it would take to make their new world secure — if only they would use them.

Over the last decade or so, the members of this organization have found themselves in a new world, one that is far from the simple or secure world you once knew.

You've come face to face with competition from institutions such as American Express, a global, full-financial service competitor if there ever was one. You've felt and you continue to feel the effects of global shifts in agriculture and in energy production and pricing on Main Streets throughout the country. You've seen a government-imposed price for money, the raw material of your business, evaporate.

And you've weathered these and other changes so far or you wouldn't be here today. Your presence here shows that you are fighters and you are survivors, that you have heart and courage. In the future, heart and courage will continue to count as bankers face economic uncertainty and ever growing competitive pressures.

But being with heart and courage, bankers who want to survive will have to make even greater use of another of your assets — your intelligence. In more ways than one, in

dependent banking's future is all in your mind. That future depends, in particular, on whether you set your minds to managing your institutions actively and diligently.

Don't take just my word for it. Take the word of this organization.

Fifteen months ago, the IBAA's official monthly magazine, *Independent Banker*, published an article titled "Avoiding the Ranks of Problem Banks." The article cited a recent independent study of bank failures that concluded most commercial banks failed due to, and I quote, "management incompetency."

"Commercial bank directors and managers have not been sophisticated enough to keep their financial institutions profitable because they were unable to adopt changes to be more competitive within the hotly contested financial services industry," the *Independent Banker* article noted.

And it continued: "Analysis of recent bank failures indicated that there are still some commercial bank victims of fraud, embezzlement, self-dealing, and conflicts of interest, but a majority of the . . . bank failures since 1985 are a direct result of mismanagement by boards of directors and managers."

The *Independent Banker* article stressed: "Most problem bank situations are exacerbated by failure of directors and senior management to recognize conditions which lead to problems . . ."

"Directors who do not supervise the affairs of the banking institution often are incapable of recognizing problem situations until they are forced to do so by regulatory agencies. Senior managers are often so overly involved in day-to-day affairs that they may miss telltale signs and conditions that can lead to significant problems."

And what actions did the *Independent Banker* article recommend?

"The first key to avoid becoming a problem bank is to assume that you could become a problem bank. Board members and senior management must develop systems which monitor the significant areas within the bank and which can provide clues to impending problem situations."

The *Independent Banker* article concluded: "To avoid becoming a problem bank, potential problems must be recognized early, and action should quickly be taken

“Managers and directors must be realistic and committed to working hard to protect the financial institutions, their employees, and themselves.”

The *Independent Banker* article parallels the findings of our own recently released OCC study of national bank failures over the last eight years.

We, too, found the quality of bank management appears to be the key to whether banks overcome problems when they arise. We found that failed banks most often were marked by a failure to have systems of control in place, clearly stated policies that officers and staff followed, competent and honest managers, and directors who took their responsibilities seriously.

In other words, we found that establishing and adhering to sound policies and procedures appear to be important to a bank's success.

Banks that fail almost invariably have poor policies, planning and management. And we found that it was often the combination of poor management and distressed economic conditions, not economic conditions alone, that was the driving force behind the failures we surveyed.

At the same time, it is important to note the other side of the equation. Some banks in economically troubled regions became problem banks — but recovered. Thousands more, primarily small institutions, faced the same economic problems, but remained healthy.

We suspect that the key to success in both cases was quality of management. And we are now engaged in the second phase of our study to confirm that belief.

In other words, we suspect that the vast majority of banks, a majority made up mostly of smaller institutions, weathered the economic storm because of the diligence and good managerial practices that bankers brought to their jobs. And as the underlying economic conditions in these regions improve, we can expect the prospects for banks to improve, as they already have in the Midwest.

Last year, great improvement occurred in the OCC's Midwestern District — the only district where the number of bank failures fell between 1986 and 1987. As the farm economy strengthened, nonperforming loans relative to total loans declined by more than a quarter and loan losses were halved. Net operating profits at national banks in that district rose by more than a third.

These are truly welcome signs that many bankers managed to survive and are managing to rebound. But as welcome as this good news is, it doesn't mean that there are no problems elsewhere, or that new problems won't arise in the future.

Bankers will continue to be tested, both by economic forces and by growing competition. As with any test, the chances of passing are far greater if you prepare beforehand.

Along with the *Independent Banker*, we recommend that bankers prepare by following generally accepted management standards: establishing systems of control and operational policies, analyzing all actions impartially, and so on.

And, most of all, we encourage all bankers and bank directors to exercise diligence in managing their bank's activities — the kind of diligence spelled out in our publication, *The Director's Book*.

Managing a bank is like everything else in life: what you get out of it depends on what you put in it.

A friend of mine back in Texas learned that lesson the hard way the time he wanted to board his horse for a short while. The first rancher he approached said he would keep the horse at \$25 a day, plus the manure. Too high, my friend thought, and he went to another rancher, whose price was \$15 a day, plus manure. Seeking yet a cheaper price, he finally found a third, who offered to board the animal at \$5 a day. After coming to an agreement with the rancher, my friend asked him: “How come you didn't ask for the manure, too?” And the rancher replied: “For \$5 a day there won't be any.”

The more you put into your institutions, the more intently you manage them, the more you will get out of them.

Now neither the OCC nor the *Independent Banker* has dredged through this history of bank failures in recent years to find someone to blame for those failures. Except for those failures that were due in whole or in part to malfeasance, a small minority of failures, blame isn't an issue here. What we hoped to do in our study was to find recurring patterns of behavior in past failures that could be brought to the attention of bankers today so that you can alter those patterns if you find them in your own institutions.

Some of the patterns we found were clearly abusive: conflicts-of-interest, self-dealing, fraud.

But for the most part, the patterns we found were not so much ones of abuse as they were patterns of neglect, whether intentional or unintentional. Given modern American banking's history of regulation, insulation, protection, it's not surprising that many bankers would have developed such a casual attitude to management in the past. But the lesson from our study is clear: a casual managerial attitude can lead to casualties.

If I could hope to leave you with one thing today it would be a heightened recognition of your own vulnerability.

You've made it through a decade of great and fundamental change in the world of financial services, but the changes of the coming decade promise to be just as great and just as fundamental, if not more so.

You cannot count on your courage — and good luck — to see you through when conditions change.

You have to guard against making mistakes.

The first European sea captain to set foot on the big island of Hawaii was Captain James Cook. His arrival in 1779 coincided with the festival in honor of the harvest god Lono. The gifts Cook offered, which seemed magical to the Hawaiians, as well as his timing, convinced the Hawaiian priests that he was indeed the god Lono incarnate.

After several weeks of rest and recreation, Cook set sail. But a storm at sea damaged the foremast of one of his ships, and he turned back. While repairs were being made, the Hawaiians stole several articles, including a ship's boat, which was burned to obtain the iron nails that the natives considered precious because they could be fashioned into sturdy fishhooks.

Cook and a party of sailors then marched ashore to take hostage the high chief and his family, holding them in exchange for the return of the ship's property. Angered, the islanders gathered at the shore. One of Cook's men fired into the crowd.

In the ensuing melee, Cook was wounded. Realizing that a true god could not be hurt, the natives fell upon the captain, stabbing him to death. Cook fell victim to the natives' knives. But in a greater sense, he fell victim to an illusion he held — the illusion that he was immune from harm — an illusion that blinded him from the danger around him.

Banking is like any other business — if you manage it right, it can be pretty good. But like any other business, even if you do the right things most of the time, one big mistake can bring you down. I hope that today I've convinced you — if you haven't done so already — to take the steps you need to take to avoid a big mistake.

In the few minutes that remain this morning, I would like to touch on one other area where we need to avoid a big mistake. Banking is different from most other businesses.

Why? Because of the dominant role that government policy plays in determining the evolution of the business of banking. As we meet here, legislation is pending in the Congress that will likely define what banking is allowed to be long into the next century.

As it now stands, there is much in that legislation that is progressive, much that would be beneficial for banking

if it is enacted, much that would allow banks to be more competitive.

But, as the supervisor of the national banking system, I must point out that in one very significant way the legislation, as it now stands, can only be described as retrograde, a step backward.

There once was a time when the banking industry split into two competing camps. I'm not referring to a division between large banks and small. Nor to a parting of the ways by old, established firms in the East and new firms on the frontier. Rather, the industry was split between those institutions chartered by the states and those chartered by the federal government — with the state-chartered institutions generally being the beneficiaries of the division.

The disparity in competitive opportunity between national and state banks was undesirable. So steps were taken to bring the two types of banks into harmony, steps such as the old McFadden Act, which was enacted to grant national banks the same branching authority as state banks had in the 1920s.

Over the years, this division, for the most part, has been erased, because the conditions underlying it were erased. As a result, I would imagine that most of you would be hard pressed to guess what proportion of the IBAA's membership had which type of charter. For the record, about a third of IBAA members are national banks.

Along with the other 2,500 or so banks chartered by the federal government, these IBAA members would see the value of their national charters decreased, discounted, diminished by the legislation the Senate Banking Committee approved last week.

If that legislation is enacted as it now stands, a substantive division between state-chartered and federal chartered banks could recur. The legislation's treatment of insurance activities by banks would bring that split about.

As a result of the political maneuvering that led to the committee's approval of the legislation, state-chartered banks would likely be granted far greater flexibility to offer insurance products to the public than national banks would.

Why? The insurance activities of state-chartered institutions would be governed, for the most part, by state law. The federal legislation would limit the offering of insurance products to persons within the state the bank calls home. But other than that, state law would establish the restrictions, if any, for state-chartered bank activities in the traditional insurance field.

National banks, however, would be far more restricted in what they could do. With two limited exceptions, national

bank insurance authority would be generally limited to the sale and underwriting of credit life, credit disability, and involuntary unemployment insurance on loans.

Several insurance activities the OCC has already determined to be permissible for national banks would be forbidden. And, with the exception of the very limited range of activities the Senate bill authorizes, the legislation would, in effect, also forbid the OCC from determining that any insurance activity is "incidental to banking" under the National Bank Act. In other words, it would resurrect the recently expired moratorium as far as the OCC, national banks, and insurance activities are concerned.

True, the split in the banking industry the legislation would cause would be limited solely to insurance activities. But what new competitive opportunity could be more important to the institutions you manage, the thousands of small banks that serve local communities throughout the country? And what about the precedent it would set for the future, as other competitive opportunities for banks are considered?

These are not just rhetorical questions when you take into account one very important fact: many financial service providers already offer insurance and banking services together.

For example, federal regulations currently authorize thrifts to engage in insurance brokerage or agency for liability, casualty, automobile, life, health, accident, or title insurance for the general public. As you know so well, these thrifts, and other financial firms, compete directly against you.

Now I support the dual banking system, as long as that

term means dual chartering and dual supervision. But as the Comptroller of the Currency, I am concerned over any prospect of creating a dual banking system where state-chartered banks have significant competitive advantages over their federally chartered counterparts, or, for that matter, a system where states would be precluded by federal law from allowing their chartered institutions from matching the competitive opportunities granted to national banks.

And as the Comptroller of the Currency, I certainly am concerned by any move that would decrease, discount or diminish the value of the national bank charter, relatively and absolutely.

As a matter of public policy, we should be seeking not to put some bankers ahead of others nor give some bankers a kick in the head.

But, in the long run, we should be seeking to put all bankers on an equal footing with their nonbank competitors, to give banks the flexibility to innovate within a framework where everyone plays by the same rules and consumers reap the benefits of creative competition.

The federal government isn't a wizard that can by magic solve banking's competitive problems. But the federal government can free banks from its constraints so that bankers can address your competitive problems yourselves.

However, we won't reach this goal if we take a step back with every step we take forward. We can't achieve competitive equality by creating new inequities in the process of righting those that are old.

Remarks by J. Michael Shepherd, Senior Deputy Comptroller for Corporate and Economic Programs, at the Annual Invited Lecture of the Economics Department and College of Business, James Madison University, Harrisonburg, Virginia, March 15, 1988

"Is the Banking System in Crisis?"

It is a great honor for me to have been invited here to address you this afternoon and to discuss with you the very important question of the future of the banking industry. Banks are the central nervous system of the economy of the world, performing vital functions as financial intermediaries: providing funds for long-term growth and short-term liquidity and facilitating national and international monetary policy. We all have a stake in a healthy, safe and sound banking system.

I have been invited to address the question: Is the banking system in crisis? The short answer is that the banking system as a whole is stable and sound and deserving of the public's continuing confidence. In terms of public policy, however, including our desire to give the financial services industry the tools and flexibility to help to marshal America's economic resources and direct them through the free market to their most efficient use, some signs of crisis are appearing. Certainly individual banks

Today, as I will discuss with you in greater detail in a minute

The bottom line is that the banking system faces unprecedented challenges from domestic competitors and from abroad. While I am responsible as a bank supervisor for systemic stability, I am not here as a bank apologist. I believe strongly that the best outcome for our country will result from free and equal competition among all financial services providers. I am not here to argue that banks should be sheltered from competition.

Today, I'd like to talk with you about the banking system and the challenges that it faces from my perspective as a Senior Deputy Comptroller of the Currency, responsible for maintaining the vitality of the nation's 4,600 national banks. These banks hold about \$1.8 trillion, or about 60 percent of the assets of our banking system, and another \$2.2 trillion of assets in trust. They range in size from most of the nation's largest banks, such as Citibank and the Bank of America, to thousands of community banks throughout the country.

In the last few years, bank performance has been uneven as economic conditions have differed among regions of the country as never before. Deregulation has allowed competition to separate winners and losers quickly and ruthlessly.

Technological developments and legal changes have inspired companies to pursue economies of scale through acquisition and to build large, multistate holding companies. As the growth momentum has built, targets and predators have altered their behavior and states have bonded together in regional compacts, allowing regional banks to grow strong enough to repulse invaders — usually from New York — when nationwide interstate banking dawns.

Sectoral Economic Problems

The effects of the strong dollar on export-dependent sectors and unfounded inflationary expectations have contributed to major weaknesses in specific sectors of the economy in recent years. These sectoral problems have resulted in continued asset quality deterioration, and a steady increase in the number of bank failures. In 1987, the number of commercial bank failures rose for the sixth consecutive year. 46 more banks failed in 1987 than in 1986, an increase of more than 30 percent in just 12 months. Failures have increased from just 7 in 1981 to 182 last year. In addition, the FDIC resolved another 19 potential failures through open-bank assistance transactions in 1987. Year-to-date, the FDIC has resolved 6 potential failures through open bank assistance transactions, and there have been 38 bank failures to date.

The increase in bank failures does not reflect a wide

spread deterioration of the banking system, however. Rather, it reflects sharp declines in certain sectors of the economy that are, in turn, adversely affecting banks servicing those sectors. The sectors of the economy most responsible for the increase in problem banks and bank failures are agriculture, energy, and real estate. In addition, some of our largest banks have lost significant income as a result of the poor credit quality of loans extended to less developed countries.

In the agricultural sector, an inflationary boom in farmland prices ended in the early 1980s. Commodity prices stagnated, land values began to fall, and the strong U.S. dollar and increased competition from foreign producers weakened demand for farm export. As collateral values declined and debt servicing capacity eroded, the quality of agricultural credits deteriorated.

Likewise, the energy sector has experienced an inflation bubble that burst, resulting in excess capacity, weak demand, and falling prices. When expected increases in oil prices failed to materialize in 1982, many oil and gas producers began experiencing cash flow problems. Increased production, especially as cartel discipline deteriorated, drove oil prices down, leading in turn, to falling values for oil and gas fields and production equipment. Commercial banks with extensive energy loan portfolios were hit hard.

With problems in the agriculture and energy sectors, troubling pressures in the real estate sector grew. The recent significant reduction in the rate of inflation, combined with overbuilding, has resulted in declining real estate values and high vacancy rates in some parts of the country. Areas that have been hit particularly hard are those that are also suffering from sectoral economic problems. Not surprisingly, the quality of bank real estate loans in these areas is deteriorating.

In addition, some of the largest U.S. banks lost significant income in 1987 because of problems in the international economy. While some 200 U.S. banks lend internationally, most of the U.S. banks' international loans are concentrated in the largest commercial banks. Depressed commodity prices, slow economic growth, high real rates of interest, and protracted debt negotiations have caused continuing payment delays from international borrowers. As a result, banks have had to place many of their international loans on a nonaccrual basis and increase their loan loss reserves. In 1987, our largest banks set aside special loss reserves of \$10 billion to cover their problem credits to less developed countries, led by John Reed's decision to add \$3 billion to Citicorp's reserves.

Economic volatility in recent years has been more severe than in past decades, bringing with it the increased bank failure rates that I have reported to you. The government,

however, neither can nor should completely insulate banks from sectoral economic downturns or the dynamics of the financial marketplace. Our bank regulatory system is not designed to prevent bank failures. To do so would require either nationalization of the banking industry, or the elimination of all risk — one consequence of which would be to preclude banks from funding the nation's economic growth. Bank supervisors do, however, have a role in minimizing the impact of bank failures and the negative effects of troubled banks on the safety and soundness of the banking system.

1987 Bank Performance

With that background, I'd now like to turn to bank performance in 1987. In many respects, the banking industry had another poor year. Preliminary 1987 bank statistics show that banking industry profits tumbled by more than \$13 billion, a drop of 80 percent. Banks earned \$3.3 billion in 1987, the lowest level in 20 years.

On closer scrutiny, however, we see some signs of improvement. For example, the decline in the banking system's profitability in 1987 is largely the result of the unprofitability of our largest banks, which set aside special reserves for international debt. The remainder of the banking system recorded profits about equal to their 1986 levels. After declining for 6 consecutive years, the median return on assets, or ROA, among all FDIC-insured commercial banks stabilized at .85 percent. Net operating income as a percentage of assets actually increased by more than 10 percent.

Credit quality also improved for the majority of banks. Relative to total loans, for example, the median level of nonperforming loans fell by more than 10 percent and the median level of net loan losses fell by more than 25 percent between 1986 and 1987, from .77 to .57 percent, to the lowest level since 1984. In addition, fewer national banks reported losses in 1987. It appears that losses may have peaked in 1986.

Another positive sign is that the number of national banks that we have determined need special supervisory attention is down from 1986, after rising in each of the previous 4 years. Moreover, the number of problem national banks declined for the first time in 6 years, from 350 in 1986 to 316 in 1987.

Furthermore, we are beginning to see improvements in the farm economy and to see some stabilization in our depressed energy sector. The improvement in the farm economy is reflected in the performance of our Midwestern banks. Bank failures in that region declined in 1987. Relative to total loans, nonperforming loans dropped by more than a quarter, and loan losses were halved. As a result, net operating profits for Midwestern

banks rose by more than one-third. Their return on assets was up by more than 10 percent over 1986.

In the energy sector, sales and employment data suggest that the trough of economic activity in Texas may have been reached. A turnaround in the fortunes of banks, especially those saddled with nonperforming real estate loans, could take considerable time, however. The overhang of vacant properties is too severe to be alleviated quickly by modest improvements in business activity. In 1987, 62 percent of all problem national banks were located in the Southwest and more than half of the bank closings were in the oil-patch states of Texas, Oklahoma, and Louisiana. Last year, more than one bank in three in the Southwest recorded losses, and the median return on assets was less than half of the national median.

Financial Reform

The answer to the question about the banking system goes deeper than the current condition of the banking industry. While we haven't reached the crisis stage, that does not mean that we have nothing to worry about. There are disturbing trends in bank return on assets and return on equity statistics.

The earnings and profitability of commercial banks are important determinants of their ability to manage economic volatility and to fund growth. A banking system requires strong, steady growth in earnings to build reserves needed to absorb losses that occur in the normal course of the business cycle. Furthermore, of course, an attractive rate of profitability is necessary to assure investors of a reasonable dividend yield and prospective capital appreciation. Bank return on assets and return on equity, however, declined steadily from 1980 through 1985, and fell to a markedly lower level in 1986 and 1987. If the banking system is to remain strong over time, these trends must be reversed.

I am convinced that the way to ensure the long-term viability of the banking industry is to grant it the flexibility to freely compete in the changing financial marketplace in which it operates. Without the ability to compete, I am afraid that we will see a widespread erosion in the strength and stability of the banking industry.

Competitive Realities

Banks do not just compete with other banks, or even just with other depository institutions. They compete with a wide variety of firms. However, while other financial institutions, like investment banks, have been relatively free to respond to market changes by offering a host of new products, commercial banks have not had the same freedom. Investment banks are now able to offer nearly a full line of commercial banking products, but commercial

banks may not offer a full range of investment banking products. This has had a deleterious effect on the efficient provision of financial services to the American public and has created competitive inequities that may eventually result in the demise of the banking industry.

In order to better explain the competitive inequities facing commercial banks today, I would like to give you a few examples of commercial banking products currently offered by other financial firms:

- Securities firms are providing the equivalent of many consumer banking services. They offer interest-bearing checking accounts in the form of money-market mutual funds, which while not technically deposit accounts, their shares are redeemed by writing checks; and consolidated packages of financial services, combining money market funds with access to stockbrokers, securities margin accounts, and debit cards through such products as Merrill Lynch's Cash Management Account.
- Securities firms also broker FDIC-insured deposits, including FDIC-insured deposits of banks they are affiliated with.
- Real estate firms offer mortgage lending services.
- Insurers offer businesses fixed-rate term loans directly and as an element of financing packages for smaller, growing companies that are beyond the venture capital stage, but are too small to float public issues.

Other competition from financial conglomerates in retail banking markets comes from their ownership of thrift institutions and nonbank banks. For example, the United Services Automobile Association offers MasterCard through its subsidiary USAA Federal Savings Bank, and Prudential offers MasterCard through Prudential Bank and Trust.

Investment bankers also have entered another traditional domain of commercial banks — the provision of credit to the corporate sector. Evidence of this competition comes from many sources. The explosive growth of the commercial paper market, which is dominated by investment banks, has displaced many bank business loans. Salomon Brothers estimates that between 1984 and 1987, bank loans as a percent of all new corporate debt issued will have fallen from 35 percent to 15 percent.

Direct access to capital markets is another version of disintermediation. It can also be seen in the growing trends of securitization. In search of more income and liquidity, major institutional lenders, including some commercial

banks, have transformed loans into securities. They pool large blocks of their own loans, issue securities backed by those loans, and distribute them to a wide range of investors. Largely because of litigation contending that the Glass-Steagall Act prohibits banks from playing a role in the distribution of those securities, that field and its profits have been left largely to investment banks.

This explosion of new products and increased competition is a welcome development, but the ability of banks to compete and survive in this financial environment is becoming more of a challenge. Congress can facilitate the long-term viability of the banking industry in this environment through the relaxation of product and geographic restrictions.

If banks are to keep pace with less regulated competitors in meeting market demands, they need more flexibility to adjust to changes in their environment. While other financial services providers have diversified, expanded, and innovated to keep pace with new technologies and market demands, banks too often have to sit on the sidelines. Providing banks or bank holding companies with new product and geographic flexibility would enable them to be viable competitors in the marketplace of today and tomorrow.

New product and geographic flexibility is also important to allow banks to reduce their vulnerability to economic fluctuations. Diversification of income sources and customer bases could greatly alleviate banks' susceptibility to economic volatility.

The Public Policy Response Should Be to Promote Competition

The social benefits of competition are so widely accepted that those pleading for an exception usually must demonstrate that the exception is socially desirable. But where banks are concerned, the tables are turned. Those who favor greater competition must make their case.

As you might have guessed, the case in favor of greater competition is fairly straightforward. It is centered on lower prices and supply effects. The effects of bank competition on prices in revenue bond underwriting has been studied extensively and there is near unanimous agreement that bank competition in revenue bond underwriting would result in substantial benefits to issuers by lowering financing costs. Two areas where bank entry has been permitted are discount brokerage and bank-owned service bureaus. No-frills brokerage services are more widely available, especially in smaller metropolitan and urban areas. Bank-owned service bureaus have provided an alternative competitive source of data processing services such as payroll and other financial accounting services to small business, public and non-profit organizations.

Some claim that greater competition in banking will necessarily lead to a less safe banking system. Not only do I disagree; I think the opposite is true. Broad-based competition would mitigate some symptoms of the pressures on banking such as the erosion of returns and of capital positions. Banks would be able to become less vulnerable to variations in the economic cycle through diversification of asset and income sources. Some of the activities protected from bank competition offer better risk/return profiles than activities permitted for banks. Surely making long-term loans to LDCs is more risky than the brief exposure of an underwriter of Exxon commercial paper!

The Legislative Response

Fortunately, we are seeing moves, both at the state level and in the Congress, that will enable banks to compete with other providers of financial services.

The states took the lead in permitting expanded intra- and inter-state geographic powers. All but six states now permit some inter-state banking and several states that permit limited inter-state acquisitions are considering more liberal codes.

Federal Legislation Appears to Be Moving Forward

The bill recently approved by the Senate Banking Committee would:

- Give banks immediate authority to underwrite commercial paper; municipal revenue bonds; mortgage backed securities; and securities backed by consumer debt.
- After 6 months, it would give banks authority to underwrite corporate debt issues and mutual fund.
- Allow such securities activities to be conducted by a subsidiary of the bank holding company.

- Provide for Congressional vote by April 1991 on legislation permitting both commercial bank underwriting of corporate equity issues and ownership of commercial banks by securities firms.
- The insurance activities of banks and bank holding companies would be restricted to their home state.

As President Reagan wrote to the Congress earlier this year: "I welcome the bipartisan initiatives of the Senate and House Banking Committees in this area, and I encourage the Congress to consider additional reforms that keep financial services open and competitive and allow the development of innovative services to benefit individuals, business, and government. In today's global economy, America's financial institutions must be released from this outdated legal framework so that they will be able to remain on the leading edge in the world marketplace."

Conclusion

Such measures recognize a growing acceptance of the view that banks compete in the market for financial services and, if they are to remain healthy, banks are going to have to have the flexibility to adapt to changing circumstances.

So, getting back to the original question: Is the banking industry facing a crisis?

The banking industry has exhibited weakness in recent years, particularly that subset of the industry that is exposed to weak sectors of the economy. But those weaknesses do not indicate fundamental problems in the industry, and, indeed, we're seeing some turnaround in the "bad news." More important is the potential for a long-term erosion of the role of commercial banks in the market for financial services. Some of you may not consider this a "crisis." But the ability of banks to adapt to changing competitive conditions will determine whether the industry continues to be viable.

Statement of William J. Stolte, Chief National Bank Examiner, before the House Subcommittee on Commerce, Consumer, and Monetary Affairs of the Committee on Government Operations, Washington, D.C., March 15, 1988

Mr. Chairman and members of the Subcommittee, I welcome this opportunity to present the views of the Office of the Comptroller of the Currency (OCC) on H.R. 3675, the Real Estate Appraisal Reform Act of 1987. The pro-

posed bill would create a new federal agency to establish uniform real estate appraisal standards and appraiser certification requirements and to determine in which federally covered transactions they should apply. The

legislation would also authorize state real estate appraiser certifying agencies that would certify and discipline appraisers.

The OCC agrees that real estate appraisals should be performed professionally. Your efforts, Mr. Chairman, have already had a notable effect on the real estate appraisal industry. In response to the Subcommittee's concerns about practitioner conduct, progress has been made by eight of the nation's major appraisal associations to govern the real estate appraisal profession. An Appraisal Foundation has been created to establish uniform appraisal standards and criteria to be used for voluntary appraiser certification. The Appraisal Foundation has already developed and adopted "Uniform Standards of Professional Appraisal Practice."

Although we agree that there is room for improvement regarding the conduct of appraisals, we have reservations about the approach proposed in H.R. 3675. Specifically, we have serious doubts concerning the costs and effectiveness of the proposed regulatory structure. In our view, the legislation would create a cumbersome mechanism that in the case of banks would not improve real estate appraisal procedures. Furthermore, it would simply duplicate efforts being taken by the appraisal industry to improve the quality of appraisals.

Before proceeding to discuss the impact of the legislation, I would like to provide the Subcommittee an overview of our experience with faulty and fraudulent appraisals in national banks and measures undertaken by the OCC to strengthen supervision and deal with problems in this area.

OCC Experience with Appraisal Policies of National Banks

As supervisors of national banks, the OCC has a clear interest in the quality of appraisals that banks obtain. First, in order to lend effectively and supervise a real estate loan portfolio properly, it is essential for banks to obtain accurate appraisals at the inception of loans and to obtain updated appraisals reflecting current economic conditions. The increased volatility in many of today's domestic real estate markets and declining property values in some sections of the country make prudent appraisal policies all the more important.

Second, we are interested in minimizing the extent of faulty or fraudulent appraisals. This problem may arise because of collusion between a party to the real estate transaction and the appraiser, with appraisers being pressured to provide an inflated valuation of a property.

Although we have found some instances of faulty appraisals, the OCC has not found that faulty or fraudulent

appraisals are a significant factor for banks that became problems or that failed. Losses in national banks' real estate portfolios are primarily due to other factors. Those factors include inadequate loan policies at the time the loan was granted and inadequate supervision of the loan and collateral after the loan was granted.

The problems we have encountered concerning real estate appraisals have centered more in bank management's failure to update existing appraisals in a timely fashion and to have sound real estate appraisal policies and procedures incorporated into a bank's overall lending policies. Such oversights can, of course, result in undercollateralized loans and, ultimately, significant loss.

OCC Supervisory Initiatives on Real Estate Appraisals

Recognizing the importance of banks' maintaining quality appraisals, the OCC has provided guidance to examiners and national banks. This guidance has included the "Guidelines for Troubled Real Estate Loans" issued to OCC examiners and national banks on October 30, 1985 and the "Guidelines for Real Estate Appraisal Policies and Review Procedures" issued jointly with the FDIC and Federal Reserve on December 21, 1987.

The "Guidelines for Troubled Real Estate Loans" emphasize the importance of accurate real estate appraisals and reappraisals in supervising a real estate portfolio in a more volatile economic climate. The "Guidelines for Real Estate Appraisal Policies and Review Procedures" remind bank boards of directors and management of the importance of sound real estate appraisal policies and procedures and reaffirm our supervisory policies regarding acceptable appraisal policies.

Among other things, the appraisal guidelines place the responsibility on a bank's board of directors to ensure that a bank's written lending policy includes a well-defined and effective appraisal program. Such a program should address acceptable standards regarding appraiser qualifications and independence, controls that ensure that adequate appraisals are obtained, and a process for reviewing new appraisal reports for adequacy and for ordering reappraisals where needed.

We believe our supervisory efforts that focus on banks' establishing sound appraisal policies and procedures are the best means of ensuring that a bank's real estate activities are conducted in a safe and sound manner. Sound appraisal policies and review procedures should provide the bank with the necessary safeguards against appraisal abuse.

OCC Views on H.R. 3675

While we wholeheartedly agree that real estate appraisals should be performed in a professional manner, we have

concerns about the creation of a new governmental agency, the Federal Interagency Appraisal Council (Council), as proposed in the bill. The Council, to be comprised of at least 10 officers and their staffs, 12 voting members from various federal agencies and two advisory committees with a total of 26 members, appears too cumbersome and diverse to be effective.

In our view, it would do little to improve the efforts of the OCC to reduce the incidence of faulty or fraudulent appraisals. Moreover, it would largely duplicate the efforts of the appraisal industry to implement improved standards for appraisals.

Additionally, the legislation would expand federal regulation into an area traditionally left to the states. Licensing and certifying individuals in various professions have historically been state functions. Should the states see a need to examine the real estate appraisal area, they should be encouraged to do so without federal involvement. The proposed legislation, however, creates a federal program with little incentive for the states to act. If a state chooses not to set up a certifying agency, for instance, the Council would ultimately fulfill a state's functions at no cost to the state.

Conclusion

Mr. Chairman, your substantial efforts in investigating and publicizing appraisal problems are to be commended. Without a doubt, they have heightened public and industry awareness of the need for improving the quality of appraisals. However, before moving forward with the legislation, I urge the Subcommittee to explore more cost-effective and workable measures to address the appraisal abuse problem.

In our view, improved appraisal review procedures and controls by lenders and enhanced self-regulation on the part of the appraisal industry represent a more viable long-term solution to the problem. As the bank regulators, we have taken steps to emphasize to users the need to upgrade appraisal policies and procedures and to establish effective appraisal programs. The appraisal industry's self-regulatory organization has adopted standards and begun to develop a certification process to enhance appraisal quality. We believe that over time the combined efforts of users and providers of appraisals can effectively achieve the goals of the proposed legislation.

Statement of Robert L. Clarke, Comptroller of the Currency, before the Senate Committee on Banking, Housing, and Urban Affairs, Washington, D.C., March 23, 1988

Introduction

Mr. Chairman and members of the Committee, I am here today to discuss the responsibilities of the Office of the Comptroller of the Currency under the Community Reinvestment Act of 1977 (CRA). The CRA was enacted out of concern that banks were making loans outside of their local communities without first considering local lending opportunities, and that there were unwarranted differences in lending patterns between neighborhoods in communities served by lenders. It emphasizes the affected lending institutions' affirmative obligations to help meet the credit needs of their local communities, while maintaining safe and sound operations.

The Office of the Comptroller of the Currency continues to endorse the broad objectives of the CRA and strives to carry out its supervisory objectives with respect to the CRA through a program that encourages positive action by the national banks which we supervise and cooperations among the OCC, the banks, and the public.

My testimony will describe the approach taken by the OCC in discharging its supervisory responsibilities with respect to the CRA. The first section will describe those supervisory responsibilities under the CRA and relate those responsibilities to our general approach to bank supervision. The second section will discuss the specific actions the OCC takes to meet its responsibilities under the CRA. Details on those activities and a description of our efforts to maintain contacts with bank customer groups are contained in a report that we provided to you, Mr. Chairman, in January. (The report is appended to this statement.)

CRA Responsibilities and the OCC's Supervisory Philosophy

The Community Reinvestment Act

The Community Reinvestment Act (12 U.S.C. 2901 *et seq.*) was enacted in 1977 and requires

each appropriate Federal financial supervisory agency to use its authority when examining financial institutions to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions.

Each agency must

assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution; and

take such record into account in its evaluation of an application for a deposit facility by such an institution.

The OCC bases its supervisory efforts on the premise that a bank's performance is, first and foremost, the responsibility of its management. Thus, in our view, we can best supervise national banks by insisting that they have policies, procedures, systems, and controls in place to ensure that their competitive efforts are consistent with safety and soundness. We monitor not only their establishment of such policies, procedures, systems, and controls, but we also make sure that they are followed. Most importantly, we make sure that they work. We do this through on-site and off-site examination and through contact with bank management and directors as needed.

We believe that this supervisory approach is effective and that it makes efficient use of our limited resources. It results in better adherence to safe and sound practices. The systems are effective because everyday management decisions are made with their guidance.

This supervisory philosophy is incorporated into our approach to discharging the responsibilities mandated by the CRA. First, we require banks to establish policies and procedures consistent with the spirit and intent of the CRA, and to establish systems to ensure that those policies and procedures are effectively implemented. Then, during the examinations, we monitor whether the banks' own systems are working, and require changes when necessary. This dual strategy of requiring systems for compliance and then monitoring the performance of those systems underlies our supervisory approach, not only to the CRA but to all areas in which banks must comply with state and federal law.

The OCC's CRA Efforts

To meet its supervisory responsibilities under the CRA the OCC

- assesses the bank's record through examinations; and
- takes the bank's record into account during the evaluation of corporate applications for deposit facilities.

The OCC has gone beyond the examination and corporate application processes by encouraging banks to increase their sensitivity to customer and community needs. Five prominent types of educational and outreach activities are discussed at length in our January report. (1) OCC-initiated meetings with customer groups and state banking and trade associations; (2) OCC-sponsored conferences, training sessions and publications on community lending and CRA issues; (3) OCC issuances; (4) participation by OCC senior management and staff at meetings sponsored by banking and bank customer groups; and (5) the OCC's Community Development Corporation (CDC) Program.

Today I would like to focus on the examination and corporate application review activities designed to encourage compliance with the intent of the CRA.

Encouraging CRA Compliance through Examination

CRA performance is assessed by examiners during all compliance examinations that we conduct. The examination is part of our overall Compliance Program — the OCC's separate mechanism for promoting compliance with a complex body of laws, including those intended to protect the community and the consumer, and to promote fair lending. After the examination, reports are provided to directors and management about their bank's CRA performance, as well as on its compliance with other laws.

Compliance with the CRA is assessed through consideration of a number of factors, both positive and negative. They include activities conducted by the bank to ascertain community credit needs, the extent of the bank's marketing efforts to make community members aware of credit services; participation by the bank's board of directors in formulating the bank's policies and reviewing its CRA performance; the existence of practices intended to discourage applications for credit from the local community; geographic distribution of the bank's credit extensions, applications, and denials; evidence of prohibited discriminatory practices; the bank's record of opening and closing offices; participation in local development projects; and the bank's origination of loans for residential mortgages, home improvement, housing rehabilitation, and small businesses or small farms.

Selection for examination. Demands on our examination force make it impossible to conduct compliance exami

nations in each of the approximately 4,600 national banks on an annual (or otherwise regular) basis. Consequently, we have developed a selection process that we believe best allocates our resources. It strikes the right balance between supervision for safety and soundness and supervision for compliance with other laws and regulations and it encourages a high degree of compliance with the CRA. The selection process provides for a thorough examination of the lead national banks (and subsidiaries and affiliates, where appropriate) of all holding companies with more than \$1 billion in assets every other year. All other national banks are selected for examination using a stratified random sample. The average probability of being randomly selected is .16, with larger institutions having a higher probability of being selected than smaller institutions. Uncertainty associated with being randomly selected provides an incentive for compliance in the same way that the possibility of being audited by the IRS provides an incentive for compliance with the federal income tax laws. During the past year, 800 individual banks have been examined under the Compliance Program, representing approximately 40 percent of the total assets of all national banks.

Other assessments of CRA performance may be conducted through targeting and special investigations of banks that were not selected under the Compliance Program. Banks may be selected for CRA examinations if they are actively engaged in expansion through merger or branching, or if the supervising examiner has discovered unsatisfactory operating procedures through the commercial examination that could call into question their CRA procedures.

Examination Results: CRA Ratings. The OCC uses a uniform interagency rating system for evaluating the performance of federally regulated institutions under the CRA. A rating is assigned to each financial institution based on the institution's performance in meeting community credit needs. Areas of evaluation include bank performance under the assessment factors detailed in the CRA regulation, public files containing comments from the community on bank performance under the CRA, and community contacts initiated by our office or by community groups. Banks may be given CRA ratings ranging from 1 to 5. A rating of 3 is given to banks whose CRA performance is less than satisfactory; a 5 rating represents a substantially inadequate record of helping to meet community credit needs. We do not believe that a large number of banks should necessarily fall into the 3, 4, and 5 rating categories. In general, we have found that banks historically have helped to meet local community credit needs, consistent with safety and soundness requirements, and that they continue to do so. In 1987, 59 national banks were rated 3, 4, or 5 for overall CRA performance.

Examination Results: Reports to Bank Management.

An integral part of the examination is the report provided to bank directors and management summarizing the results of the examination. The report contains the examiner's assessment of the bank's CRA performance and any recommendations for improving that performance. This guidance provided to management through the written report and recommendations promotes a high level of CRA compliance.

Encouraging CRA Performance through the Application Process

The OCC considers the CRA performance of national banks when evaluating their corporate applications for charters, charter conversions, branches, mergers, and relocations of home and branch offices. This information is derived from examinations conducted in the course of the Compliance Program, and from targeted examinations or special investigations triggered by an application, from data collected under the Home Mortgage Disclosure Act, and from public comments.

Since enactment of the CRA, the OCC has denied four corporate applications due to less than satisfactory CRA performance. This low number reflects our view that conditional approvals are more effective than denials in promoting the objectives of the Community Reinvestment Act. The OCC has approved 23 applications with specific conditions requiring the applicant banks to strengthen their CRA performance. Under such circumstances, the banks cannot consummate the transactions in question until they provide concrete evidence to the OCC that their CRA performance has been strengthened. As a result, the conditional approval approach provides the OCC with substantial enforcement leverage by explicitly tying a bank's achievement of a desired objective to improvement of its CRA performance. This procedure produces results. And communities benefit through the corrective actions taken in response to the OCC-imposed conditions.

In addition to the OCC's action on the approval of applications, the objectives of the CRA can be promoted by meetings between applicants and concerned community groups while an application is in process. However, the OCC does not require, and does not intervene in, such meetings, nor do we approve or monitor performance under any agreements that may be negotiated between applicants and community groups.

Summary and Conclusion

Mr. Chairman, the OCC has developed a comprehensive program to encourage national banks to help meet the credit needs of their local communities. We believe that we have developed a program that strikes the right balance between the competing demands for our super

visory resources. We use on-site examination programs to make sure that national banks comply with the law. We train our examiners to assess national banks' compliance efforts and accomplishments. We consider the results of our assessments in evaluating corporate applications and have caused national banks to strengthen their CRA performance. We maintain contacts with community and banking groups to help ensure that all parties understand the needs and resources of each other.

We believe that most national banks help meet the credit needs of their local communities in the ordinary course of doing business. The OCC has not found it necessary to deny many applications on CRA grounds. Denials are a last resort. They are used only when the far more effective tactic of conditional approval has little, if any chance, of modifying bank performance.

Appendix

Administration of the Community Reinvestment Act by the Office of the Comptroller of the Currency

January 1988

I. Introduction

This report was prepared in response to a request from Senator William Proxmire, Chairman of the Senate Committee on Banking, Housing, and Urban Affairs, for information on the enforcement of the Community Reinvestment Act (CRA) by the Office of the Comptroller of the Currency (OCC). It provides commentary and data on CRA training for examiners, the results of CRA examinations, the disposition of applications subject to CRA, and the other issues Chairman Proxmire specifically asked the OCC to address. To assist in an understanding of the entire OCC effort under CRA, this report also contains information on OCC compliance with requirements not raised by Chairman Proxmire. The remainder of this Introduction sketches all the requirements imposed by CRA and outlines the body of this report.

The Community Reinvestment Act

The Community Reinvestment Act (12 U.S.C. 2901 *et seq.*) was enacted in 1977 and requires:

each appropriate Federal financial supervisory agency to use its authority when examining financial institutions to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions

Each agency must

assess the institution's record of meeting the credit

needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution, and

take such record into account in its evaluation of an application for a deposit facility by such institution.

The term "application for a deposit facility" is defined to include applications for charters (including charter conversions), branches, mergers, relocations of home and branch offices, and deposit insurance.

The term "examining," as used in the law, also requires comment. The OCC has long viewed its basic mission to be that of supervising national banks. Supervision requires ongoing monitoring of bank activities and contact with bank officials as needed. Supervision includes, but is not restricted to, on-site examination. Consequently, the OCC has interpreted the Congressional mandate "... to require the use of its authority when examining banks . . ." (emphasis added), to require the use of its authority when supervising banks. That interpretation underlies its view of its CRA responsibilities.

Outline of Report

The OCC activities designed to meet its CRA responsibilities can be classified in terms of the broad requirements found in the law. The OCC encourages national banks to meet local community credit needs through its examination and corporate application processes and through a number of other activities designed to increase the sensitivity of national banks to CRA-related issues and community lending opportunities.

Activities to encourage national banks to meet community credit needs are described in the next section. They include OCC initiatives to meet with bank customer groups, sponsor programs for bankers and community leaders, issue advisories on bank responsibilities to local communities, participate in programs initiated by bank customer groups, and encourage bank investments in community development corporations and community development projects.

Section III describes how the OCC has prepared itself to assess the CRA performance of national banks and encourage them to help meet community credit demands through the examination process. It covers OCC examination priorities and policies, examination programs, the training of examiners, and the resulting CRA ratings of national banks.

Section IV describes how the OCC uses CRA ratings and other relevant material in evaluating corporate applications subject to CRA. Topics covered include OCC proce

dures for public comment, the use of data compiled pursuant to the Home Mortgage Disclosure Act (HMDA), and the disposition of corporate applications since 1981.

Section V addresses the CRA compliance-related issues such as public disclosure of CRA ratings, the expansion of HMDA reporting requirements to include small businesses, and the possible impact of securitizing mortgages on CRA compliance by national banks.

Section VI contains a summary and conclusion.

II. Activities to Encourage Banks to Meet Community Credit Needs

In the examination process, the OCC encourages banks to help meet community credit needs through examiner discussions and recommendations to bank management. Through its Customer and Industry Affairs Division, the OCC provides encouragement to banks via an ongoing program of activities to help facilitate increased banking industry sensitivity to customer and community needs. This is accomplished through (1) OCC-initiated meetings with customer groups; (2) OCC-sponsored conferences and publications on community lending and CRA issues; (3) OCC issuances; (4) participation by OCC senior management and staff at meetings sponsored by banking and bank customer groups; and (5) the OCC's Community Development Corporation (CDC) Program.

Meetings with Bank Customer Groups

The OCC coordinates activities to increase interaction among the Office and consumer, community, and other groups, to monitor CRA issues, and to offer feedback to the banking industry. In 1985, the OCC's Customer and Industry Affairs Division, in concert with District offices, conducted "Bank Customer Group Key Issues Meetings" in each of the OCC's six districts. The purpose of the meetings was to discuss a broad range of CRA, consumer, housing, and small business issues and concerns and obtain customer group perspectives on bank and OCC performance. "Summary Reports" for the meetings were developed and provided to all national banks, customer groups in each district, key OCC policymakers, and other federal financial regulatory agencies.

To obtain a broader, national perspective, the OCC arranged a "National Bank Customer Groups Key Issues Meeting" in April of 1986. That meeting brought together the Comptroller, senior OCC management, and representatives of nationally based bank customer groups for a dialogue on banking issues that affect consumers, small businesses, and community, civil-rights, housing, and state- and local-government organizations. A comprehensive summary of that meeting, which included a discussion of concerns national groups raised about CRA regu-

lation and bank performance, and OCC responses to those concerns, was provided to all national banks, national customer groups, bank trade associations, and other regulatory agencies.

In 1987, the OCC implemented a process under which District Offices conduct their own community outreach and contact programs to elicit customer group perspectives on bank performance under the CRA and other consumer compliance laws. Information collected through these outreach programs is utilized during the CRA assessment process and in District Office communications on compliance issues with banks.

OCC-Sponsored Conferences and Publications

The OCC sponsors conferences and roundtables for bankers on issues related to community lending. One of the primary purposes of these meetings is to develop and provide information to national banks about the successful approaches banks have used in meeting community credit needs. In each case, a publication based on the proceedings of the meeting has been provided by the OCC to national banks. Over the last few years these conferences have included:

- "Small Business Lending and Private Secondary Markets." A 1984 roundtable, cosponsored with the National Federation of Independent Business (NFIB), highlighted innovative bank programs to make available long-term, fixed-rate financing to smaller businesses. The purpose of the program was to educate bankers and leaders in the public and private sectors about opportunities and new approaches in small business finance and to encourage them to work together to implement creative long-term financing programs. It addressed new developments in the lending field with banks serving both as loan originators and as sellers of loans to other investors with long-term investment horizons, such as pension funds. Approximately 50 leaders from the banking, small business, and governmental sectors participated in the meeting. A publication based on the roundtable was written and provided to over 2,000 national banks.
- "The Changing Shape of Retail Banking Responding to Customer Needs." a major national conference, was held in June 1985. Over 220 people attended including bankers, community, consumer and small-business leaders, and bank trade association representatives. The goal of the meeting was to help participants adapt to change and understand the evolving role of the bank customer. It was also meant to assist the OCC in understanding the concerns and needs

of the industry and customer groups. Senior OCC officials and guest speakers discussed the importance of understanding customer needs. Four conference workshops, with bank and customer group speakers, included "Branch Banking in the Eighties," "Responding to the Small Business Market," "Initiatives in Low-Cost Banking and Consumer Education," and "Community Investment: A Market Development Strategy." A Conference publication was made available to bank customer groups and banking organizations. It was sent to approximately 1,500 national banks.

- "Opportunities and Issues for Banks in Affordable Housing" was the subject of a roundtable sponsored by the OCC in December 1986. The purposes of the roundtable were to heighten the awareness of bankers regarding opportunities for investment in affordable housing programs and highlight several effective financing programs offered by banks or through partnerships in which banks participate. The roundtable attracted more than 100 participants, the great majority of whom were bankers. Three panels addressed innovative approaches for bankers, other in the private sector, and governmental bodies to work together to provide housing for low- and moderate-income people. Some of the models discussed included bank community development corporations, the Chicago Equity Fund, the Local Initiatives Support Corporation, the Enterprise Foundation, and the Boston and Baltimore Housing Partnerships. A publication summarizing the proceeding was sent to over 3,000 national banks and other interested parties.

Additionally, in 1987 the OCC published and distributed *The Director's Book: The Role of a National Bank Director*. That publication outlines the responsibilities of national bank directors and highlights areas of particular concern. A major section entitled "To Ensure that the Bank Serves the Credit Needs of the Community" is intended to remind bank directors of their banks' CRA obligations and encourages them to take an active role in developing and reviewing bank CRA-related initiatives.

OCC Issuances

Additional encouragement is provided to national banks through the issuance of banking circulars that alert banks to common issues and compliance concerns affecting national banks that the OCC has noted through examinations or through its outreach and monitoring activities. CRA-related issuances have included

- Banking Circular 189—Branch Closings and Reductions in Service—which encouraged

national banks to develop and implement policies for branch closings to minimize adverse effects on the bank's community;

- Banking Circular 206, "Basic Banking Services," which encouraged national banks to provide basic banking services to their customers, including low- and moderate-income, young, and retired persons who may be unable to pay regular charges for conventional banking accounts.

Additionally, the Office provided assistance to the American Bankers Association in developing a Branch Closings Manual, which was designed to help banks make informed decisions when branch closings appear necessary.

Participation in Conferences and Programs

The OCC participates at conferences and other meetings and provides ongoing assistance to banking organizations, customer groups, and other interested parties to help them develop and implement informational programs and prepare publications that are related to the CRA compliance responsibilities of banks and to bank participation in special community financing programs. Over the last few years those activities have included the following.

- The Comptroller, senior OCC managers, and OCC staff have addressed numerous conferences and workshops sponsored by the American Bankers Association, the Independent Bankers Association of America, the Consumer Federation of America, the National Bankers Association, the National Training and Information Center, and other organizations.
- The OCC, as a member of the Executive Committee on Government/Business Small Business Capital Formation regularly provides assistance to the Securities and Exchange Commission in planning its annual Small Business Forum. In 1987, the SEC Forum focused on models and approaches used to provide equity and long-term financing for small businesses and included a number of bank-sponsored model programs.
- Each year, the OCC responds to requests from bank customer organizations to participate at conferences and to provide informational materials that address banks' CRA obligations and bank participation in community financing programs. Such assistance includes the provision of OCC speakers and informational materials and advice on bank programs and speakers that could be featured. In November 1987, the Comp-

troller addressed a major conference sponsored by six national customer groups, "Community Rights and the Banking Industry," emphasizing the importance of the CRA and the OCC's activities designed to encourage bank performance and accountability. Other organizations assisted in 1987 were the National Council for Urban Economic Development, the National League of Cities, the Southern Growth Policies Board, the Black Business Investment Board of Florida, the National Center for Policy Alternatives, the National Training and Information Center, the National Congress for Community Economic Development, and the Consumer Federation of America.

OCC's Community Development Corporation Program

Bank community development corporations and community development investments are tools that can help banks meet community credit needs. In 1978, the OCC formalized its Community Development Corporation Program, which allows national banks to make direct equity and other investments in community development corporations (CDCs), business ventures, or community development projects serving predominantly civic, community, or public purposes.

In 1984 the Office issued Banking Circular 185, "Community Development Corporations." The Circular describes the OCC's policies, procedures and guidelines for national banks wishing to organize or invest in CDCs or invest in community development projects.

During 1987, over 125 inquiries were processed from parties interested in establishing CDCs. To date, 29 national bank CDCs have been approved by the OCC. A number of these CDCs have multiple bank investors. Almost 100 banks have invested in CDCs or community development projects under the OCC's program. National bank CDCs and community development investments have focused on housing development and rehabilitation, downtown and neighborhood commercial revitalization, industrial development and redevelopment, small and minority business assistance, neighborhood marketing, and the provision of training, technical assistance, research, and planning for nonprofit development groups.

1987 CDC activities by the OCC included the following:

- CDC information package. This package, entitled "Community Development Corporation Program for National Banks," was designed to provide national banks and others with important information on OCC's policies and procedures governing bank community development investments and to encourage banks to consider such

investments as part of their overall program to help meet community credit needs. The package included five separate pieces of information. Distributed initially in March 1987, the package was used extensively by the OCC throughout the year to respond to banker requests for information about CDCs and community development investment options. In addition, upon request, the package or individual pieces, were provided to customer groups, federal, state- and local-government agencies, and a variety of customer groups and bank trade associations for use at their conferences and other programs. To date, over 4,500 packages have been distributed. The information pieces in the package included four brochures:

- "National Bank Community Development Corporations and Community Development Investments,"
- "Community Development Corporation Program Questions and Answers,"
- "National Bank Community Development Corporations: Directory,"
- National Bank Community Development Corporations: Background Information," and
- a copy of Banking Circular 185: "Community Development Corporations."
- CDC exhibit. The OCC prepared and presented an exhibit on national bank CDCs at the ABA's Real Estate Finance Conference held in March 1987. The exhibit helped distribute the CDC information package and explain the benefits of CDCs to many of the 350 bankers who attended the conference.
- Financial Institutions' Community Development Corporations Forum, August 13, 1987 in Washington, D.C. To promote bank and bank holding company community development corporations, the OCC, together with the Board of Governors of the Federal Reserve System, convened this forum to provide information about bank-related CDCs and community development investments. The Forum was attended by over 200 individuals, including current CDC officials, bank and bank holding company representatives, and others interested in CDCs. The Forum included information on how to form a CDC, highlighted new and innovative housing and small business development approaches of current CDCs, and explained the OCC's and the Federal Reserve's CDC approach procedures

III. Developing Examination Resources to Assess and Encourage CRA Performance

The OCC has experimented with a number of ways to meet its responsibility to assess the CRA performance of national banks and to encourage them to respond to community credit demands through the examination process. This section details OCC efforts to develop the resources to meet that responsibility. It describes the changing nature of CRA examination programs and examiner training, as well as OCC judgments about compliance with CRA by national banks.

Early CRA Examination Priorities and Policies

The OCC began giving special emphasis to consumer compliance in 1974. At that time it created the Consumer Affairs Division, which was responsible for coordinating all complaints and examination-related activities in the area of consumer protection. Its activities included monitoring the training of consumer examiners and developing their examination tools and procedures, including the *Comptroller's Handbook for Consumer Examinations*, first published in September 1977.

With the enactment of the Community Reinvestment Act in 1978, the law's requirements quickly became part of the previously established consumer examination program at the OCC. The implementing regulation (12 CFR 25, promulgated in October 1978) was added to the *Comptroller's Manual for National Banks*. After more than a year of field testing by OCC consumer examiners, examination procedures were added to the *Handbook for Consumer Examiners*. Also added to the *Handbook* in 1979 were a chapter explaining the requirements of CRA and a series of questions and answers designed to make banks aware of their CRA responsibilities.

The OCC formally initiated separate consumer compliance examinations in 1977 and intensified training programs to ensure the availability of the requisite personnel. From 1977 to mid-1983, all consumer-trained examiners participated in an intensive, sequestered 2-week national school. Comprehensive instructions on CRA assessment and the examination process were taught. On-the-job training was also required after completion of the school. Most of those examiners performed consumer examinations exclusively for at least 6 months.

Experience showed that the initial intensive approach to consumer examinations required a substantial commitment of resources from both OCC and all banks. The benefits of added compliance that were achieved for those national banks that needed to improve their record of compliance did not justify that commitment. A different approach was needed - one that could ensure a high level of compliance by all national banks but at the

same time make more efficient use of agency and bank resources by focusing on those banks in greatest need of improving their performance. Additional incentive to develop a more efficient approach was provided by OCC senior management, who wished to contribute to an administration effort to reduce regulatory burdens in the marketplace.

In 1982, the OCC implemented a new approach to both commercial and consumer examinations that involved a two-tiered integrated examination. Both compliance with the law and the pursuit of safe and sound banking practices by each national bank were to be judged initially in terms of the quality of the operating procedures used by each national bank. If weaknesses were found, a more intensive examination procedure was to be employed, targeted at areas of weakness. In addition, commercial and consumer examination procedures were integrated. OCC training objectives were subsequently changed to reflect the change in supervisory goals.

In mid-1983, as the Office undertook efforts to use its limited resources more efficiently, consumer compliance training was transferred to the district level. A self-study course was made available to all examiners, and, depending on resources, a classroom course was conducted to supplement self-study and on-the-job training.

Full and continuing implementation of those procedures was impaired by unanticipated and substantial increases in the number of banks requiring special supervision, the number of bank failures, and the resulting pressures on the federal deposit insurance fund. Examiner resources that the OCC had originally believed would be available for full implementation of the modified consumer examination procedures had to be diverted to assessment of the safety and soundness of national banks. Against this background, the OCC made further adjustments to its consumer compliance efforts.

Current Examination Programs

The current Compliance Program, designed in 1986, was made fully operational in 1987. Under the Program, examiners initially assess compliance by evaluating a bank's procedures and policies designed to ensure adherence to a number of laws and regulations. They include the Bank Secrecy Act; the Community Reinvestment Act; fair lending laws, such as the Equal Credit Opportunity Act and the Fair Housing Act; insider transactions; consumer protection laws, such as the Truth in Lending Act; and adherence to fiduciary principles in the performance of fiduciary powers. The operation of electronic data processing centers and bank dealer activities are also examined. The heart of the program is the selection of a stratified random sample of national banks for an in-depth review of their compliance efforts and

accomplishments. The uncertainty associated with being selected in the sample provides an incentive for compliance.

The first component of the Compliance Program is to conduct thorough and consistent examinations of a stratified random sample of banks and provide reports to bank directors and management on their CRA performance. National banks with over \$1 billion in assets, of which there were 204 as of September 30, 1987, are examined every 2 years. The other 4,442 national banks with under \$1 billion in assets are examined when they are selected through the sampling process, so the time between examinations will vary. (The sampling is biased toward the larger institutions.) The overall probability of selection for the small banks is .16 each year. During the 1987 cycle, over 800 banks were included in the sample of institutions examined under the newly instituted Compliance Program.

Other CRA assessments may be conducted through targeting and special investigations of banks not selected by the sampling procedure. Banks may be selected for CRA examination, for example, if they are known to be planning an expansion through merger or branching, or if the supervising examiner has discovered unsatisfactory operating procedures through the commercial examination.

The OCC does not have precise information on the amount of time devoted specifically to on-site CRA examinations; its time reporting system categorizes examination time only for consumer compliance generally. However, approximately 20 percent of the time spent on the consumer-protection of an on-site compliance examination is devoted to CRA. That figure was used to develop the data presented in the following table, which covers the second and third quarters of 1987.

*Estimated On-Site Examiner Time Devoted
to CRA Compliance*

March - September 1987

<i>Asset Size¹</i>	<i>Work Days/Bank Examined</i>
Under \$50 million	2.5
\$50 million to \$100 million	2.5
\$100 million to \$300 million	3.0
\$300 million to \$1 billion	4.5
\$1 billion to \$10 billion	9.0
over \$10 billion	16.5

¹Asset size categories used in the analysis of OCC's compliance program. Size categories requested are not available.

The second component of the Compliance Program involves extensive OCC efforts to inform bank management of their compliance responsibilities through the use of banking issuances and advisories. Four advisories,

covering a broad spectrum of issues including speculative trading activities, disclosure of the method of calculating interest on deposit accounts (the investable balance issue), bank's investments in government securities mutual funds, and home equity lines of credit, were distributed to the industry in 1987.

More formal banker education is a large part of the OCC's new approach to compliance. In 1987, the OCC, through its Consumer Activities Division, provided speakers for over 30 seminars and training sessions sponsored by trade and state banking associations promoting compliance with consumer protection laws and regulations. Of particular importance in this education effort was OCC's participation in the American Bankers Association (ABA) "Bank Compliance Symposium," which was televised to over 3,000 bankers and included segments on compliance with CRA and other consumer-protection laws. OCC's Compliance Department staff also participated in ABA's first National Compliance Conference and discussed the Compliance Program and CRA. The Office also sponsored a briefing on the Compliance Program for over 25 leading consumer and community group representatives informing them of the basic components and objectives of the program.

A third component of the Program is the simplification of compliance with regulatory requirements. For instance, a national bank examiner in the Consumer Activities Division developed a microcomputer program that makes it much easier to compute accurate annual percentage rates, in conformity with Federal Reserve Regulation Z. This program was distributed to all OCC examining staff, the FDIC, and the Federal Reserve Board. It is also being distributed to the banking industry through the American Bankers Association. Other computer programs are being developed that will simplify compliance with other regulations.

The fourth component of the program will be the development of off-site evaluation techniques. With the completion of the first cycle's compliance examinations in April of this year, we will analyze the examination data to determine if there are certain characteristics that may indicate the quality of compliance performance. If that effort proves fruitful, the OCC may be better able to allocate its resources to address more efficiently and effectively potential problem areas.

Finally, we will deter noncompliance throughout the national banking industry by taking appropriate action to correct detected problems. The OCC believes that these efforts comprise a program that efficiently and effectively promotes compliance with CRA and other laws and regulations.

A special program for multinational banks. A project undertaken prior to the full implementation of the new

Compliance Program added materially to its current scope. In the fourth quarter of 1986, the OCC conducted extensive CRA examinations in each of the multinational banks and seven of their affiliate banks. That effort involved background meetings between OCC staff and community representatives, both in Washington and in the cities in which the banks are located, for the purpose of alerting examiners to the concerns of community groups. Community profiles on the seven cities in which the multinational banks are located were also developed, with the assistance of the OCC's Customer and Industry Affairs Division.

Continuing dialogues with the managements of the multinational banks contributed to additional improvements in the OCC's Compliance Program. Currently, the OCC seeks to ensure that bank Boards of Directors are fully informed of the examiner's findings and requires detailed information on corrective actions undertaken to monitor their effectiveness. When the banks that have received less than satisfactory ratings make corporate applications, the OCC will require them to (1) take appropriate action to correct cited problems; (2) provide detailed reports on improvements to CRF performance; and (3) provide an account of CRA accomplishments made since the most recent examination.

Current Examiner Training

Under our current Compliance Program, each examiner is trained to conduct CRA assessments as part of broader compliance examination training. Compliance training typically occurs after the examiner has been with the Office for between 12 and 30 months, depending on the availability of district resources.

Additionally, a revised consumer compliance self-study course has recently been piloted and will be distributed to the districts in the first quarter of 1988. The OCC is also implementing a 40-hour tutorial, produced by the ABA and OCC staff, on consumer-protection laws and a consumer school that will be held in the districts. The participants will be tested at the conclusion of the school, identifying those who require monitoring by field managers to overcome deficiencies. The new curriculum including preliminary reading, time in class, and testing will take from 3 to 4 weeks to complete.

An advanced consumer compliance seminar is also offered to commissioned national bank examiners who have completed the district-sponsored consumer school and who will be conducting the consumer portion of compliance examinations. At the seminar, leaders from holding companies, banks, consumer and community groups, and other financial regulatory agencies offer different perspectives on a variety of consumer-oriented issues including CRA. The OCC is also developing a seminar for

managers who administer the examination process in the field and who review compliance examination reports.

Examination Results: CRA Ratings

The OCC uses a system of individual ratings that summarizes the examiners' view of bank compliance with CRA objectives. A rating is based on the evaluation of a number of areas, including bank performance under the assessment factors detailed in the CRA regulation, public files of comments from the community on bank performance under CRA, and community contacts made through our outreach programs, as described in Section II of this report.

Banks may be given CRA ratings ranging from 1 to 5. A rating of 3 is given to banks whose CRA performance is less than satisfactory; a 5 rating represents a substantially inadequate record of helping to meet community credit needs. We do not believe that, *a priori*, a large number of banks should fall into the 3, 4, and 5 rating categories. In general, banks historically have helped to meet local community credit needs, consistent with safety and soundness requirements, and they continue to do so.

In 1986, 45 national banks had CRA ratings of 3, 4, or 5. Forty-two were the result of examinations conducted that year; three were carried forward from previously conducted examinations. The total number of less than satisfactory ratings represents 3 percent of the banks that received consumer compliance ratings in 1986. In 1987, 59 national banks, 5 percent of those that received CRA ratings that year, were rated 3, 4, or 5.

IV. CRA Performance and Corporate Applications

To meet its third requirement under CRA, the OCC considers the CRA performance of national banks when evaluating their corporate applications. Information incorporated into those evaluations is derived from sources described elsewhere in this report, *i.e.*, examinations conducted in the course of the Compliance Program and targeted examinations or special investigations triggered by an application, from data collected under the Home Mortgage Disclosure Act (HMDA), and through public comments.

Opportunities for Public Comment

OCC policies and procedures for the disposition of corporate applications offer extensive opportunities for public comment. Those opportunities may be found in certain provisions of our regulation 12 CFR Part 5, "Rules, policies, and procedures for corporate activities."

In particular, section 5.8 requires all applicants to notify the public of its application by publishing a notice in a

"... newspaper of general circulation in the community in which the applicant proposes to engage in business. The notice shall state that an application is being filed as of the date of the notice, and the notice shall contain the name of the applicant(s) and the subject matter of the application." In addition to the requirement for public notice by the applicant, the OCC publishes a notification of receipt and disposition of applications in its *Weekly Bulletin*. The *Weekly Bulletin* is distributed to subscribers within 3 weeks of the date of receipt of disposition.

Section 5.9 requires the OCC to maintain a public file for each application. The public file contains the application and, with certain exceptions, supporting data and supplemental information filed by the applicant(s). It also contains "... all data and information submitted by interested persons in favor of or in opposition to such application ...". Ordinarily, interested persons are given 30 days after the publication of the notice to provide comment. However, the OCC may extend the comment period, if there are extenuating circumstances.

Section 5.10(b) offers the opportunity for a public hearing. Because the expenses of a hearing to all concerned are substantial, a hearing is granted only if the OCC determines that, "... written submissions would be inadequate or that a hearing would otherwise be beneficial ...". The OCC does not maintain extensive historical records on applications for hearings. However, in the first 11 months of 1987, there were 18 requests for hearings of which 17 were denied. One request for a hearing was granted. It was not held, however, because the parties resolved their differences outside the hearing process.

When applications are protested on CRA grounds, the OCC encourages, but does not require, further communications between the contesting parties. Any agreement they might reach is not subject to OCC approval or enforcement. However, the OCC does consider information on the extent to which a bank adheres to an agreement when assessing its record in meeting the credit needs of its community. We also take into account any negative effects that may result from a bank's decision not to meet with community groups.

The Use of HMDA Data

The Home Mortgage Disclosure Act requires insured commercial banks with a home or branch office in metropolitan statistical areas to maintain and file with the Federal Reserve certain residential mortgage loan data. Those data are intended to reveal the size of mortgage loans and the locations of properties used to collateralize them. OCC examiners take HMDA data into consideration when making their CRA evaluations.

Examiners view HMDA data that indicate a disproportion-

ately low level of lending to low- or moderate-income areas, compared to other areas in the local community as a warning signal that CRA performance may be inadequate. However, an indication of disproportionate lending patterns would not itself be cause for denial of a corporate application. The examiner would need to investigate further. The bank might be meeting its CRA obligations in other ways. It could, for example, be engaged in commercial banking for multiple-family housing.

In the final analysis, if the OCC did determine that an unreasonable pattern did exist, the corporate application could be denied. However, an approval with conditions might be a more appropriate response.

The Disposition of Corporate Applications

The OCC has found that conditional approval is an effective means of CRA enforcement. It commits the bank to improve compliance, and the OCC's appropriate district office monitors the bank's fulfillment of the conditions. The community benefits through corrective actions taken in response to the OCC's conditional approval. A blanket denial, by contrast, might result in the applicant taking no action. Nonetheless, denials have been and will be used in those cases where no agreement can be reached in the short-term or when the bank is uncooperative.

Protested applications. Since 1981, of the more than 10,000 corporate applications received by the OCC, 38 have been the subject of a CRA protest. Of those 38, 28 were approved without conditions, two were approved subject to conditions not related to CRA, one was withdrawn, and seven are pending.

Corporate applications from banks with adverse CRA ratings. Approximately 50 corporate applications from institutions with CRA ratings of 3 were approved last year. However, in each instance the bank's record of performance was reviewed and it was determined that there were mitigating factors present to lessen the agency's supervisory concerns. Examples of such factors include determinations by the OCC that the bank had satisfied requirements previously dictated by the agency, or that the bank was making adequate progress towards correcting its CRA problems; that the ratings were attributed to inadequate bank monitoring systems and not a disregard of community credit needs; or with respect to acquisitions in failed or problem bank situations, that the potential adverse effects of the absence of a bank in the community outweighed the agency's CRA concerns.

Since 1986, no applications from institutions with CRA ratings of 5 have been approved. Agency records reflect approvals for one bank that had a CRA rating of 4. In this case, approval was deemed appropriate because of

the bank's response less in correcting the CRA problems and additional positive findings during a followup review by the OCC. That review revealed a more extensive advertising and marketing program and a more extensive involvement in community development programs than previously disclosed. In addition, bank management had committed to developing and documenting a systematic program for officers to go into their communities, especially low- to moderate-income areas, and establish a meaningful dialogue with community organizations and leaders regarding the community's credit needs. The bank had begun to hold such meetings with community leaders. This information was available to the OCC during the review of the application. The bank's rating was subsequently upgraded to 3.

Denials. Since enactment of the CRA, the OCC has denied four corporate applications due to CRA factors. That number reflects a weighing of numerous considerations. Many applications seek approval to establish new facilities, such as branches and automated terminals. Denial of such applications could be counterproductive. It could restrict the supply of services to the community at large. It could reduce the amount of leverage available to the OCC in its efforts to encourage improved CRA performance.

The OCC believes that conditional approvals are more effective than denials in securing such improvement. Consequently, it has approved at least 23 applications with specific conditions requiring the applicant to strengthen its CRA performance. The OCC action was based on an independent assessment of the applicant's CRA record. The conditional approvals did not involve protested applications.

V. Other CRA-Related Issues

Public Disclosure of CRA Ratings

Some leaders of community groups have urged federal bank supervisors to make the CRA ratings of individual banks public. Two considerations argue against such disclosure.

First, it is not clear that such release would serve a useful purpose. CRA ratings (like the other summary rating systems used by the banking agencies) serve an important, but limited, purpose for the supervisory agencies. In essence, the rating is the assignment of a quantitative value to the bank examiners' evaluation of a number of qualitative factors. The rating, however, is but a general indicator of a bank's CRA performance. It implies little about specific deficiencies or how the bank is addressing them.

Second, it does not appear that the release of CRA ratings is needed for the purpose of informing the public of a bank's performance in meeting community credit

demand. National banks and the OCC maintain files that contain public comments on the efforts of national banks to address community credit needs. Those files are available to interested members of the community to assist them in assessing a bank's CRA performance.

Expansion of HMDA to Include Small-Business Loans

Appeals have also been made to apply disclosure requirements similar to those of the Home Mortgage Disclosure Act to lending by banks to small businesses. The OCC does not think such a disclosure requirement would be appropriate. In particular, it is unlikely that the benefits of having that information available would justify the costs that would be involved in reporting and compiling it, assuming the disclosure requirements were to mirror those of HMDA.

Lenders would be faced with significant costs to create and maintain the disclosure system. Because small business loans are not a homogeneous product like home mortgage loans, the costs are likely to be substantially greater than for the present requirement.

In addition to the burden placed on financial institutions, the burden placed on the banking agencies would undoubtedly be high. Currently, the OCC is required to review approximately 3,000 HMDA disclosure forms. Before those forms are transmitted to the Federal Reserve Board (FRB) for processing into the HMDA Aggregation Tables, each form must be manually edited for errors and assigned a 13-digit identification code provided by the FRB. Each of the six district offices must bring in field examiners to perform this task. It takes 11 field examiners more than 2 months to complete the editing of HMDA reports. Expanding the disclosure requirements to include small business loans will add significantly to this already resource-intensive task.

No doubt, there would be some benefits of having information on small-business loans. It would be useful in assessing the CRA record of financial institutions, and it could help state and local governments and community organizations to ascertain whether small business lending is an important part of a bank's business. But there are less costly ways of obtaining such data. Interviews with bank management and loan officers and with small business organizations are one source. Voluntary surveys of businesses and banks are another source—one that would be less costly than nationwide data gathering. Furthermore, a survey tailored to local needs is likely to generate more useful information than one based only on geographic location.

Secondary Mortgage Market Standards and CRA

There have been some expressions of concern that secu-

ritizing mortgages and other secondary mortgage market developments might bias extension of mortgages in low-income areas. Although the OCC is aware of anecdotal evidence that banks avoid some lending because of secondary market requirements, it is not aware of any formal complaints alleging that national banks have avoided such lending because of the application of secondary mortgage market standards when underwriting mortgage loans. Nor have any examiners reported compliance violations attributable to that source.

The existence of secondary mortgage market standards does not diminish the responsibilities banks have under CRA; given the anecdotal evidence, the OCC is alert to the possible supervisory ramifications of this issue. Our awareness has been heightened through contacts with community groups and concerned bankers. The topic was discussed at national and regional bank customer group conferences that the OCC convened in 1985 and 1986. In September of 1987, it was the subject of a highly constructive roundtable, co-sponsored by the American Bankers Association Consumer Issues Task Force and the Association of Community Organizations for Reform Now (ACORN), that involved representatives of community groups, banks, secondary mortgage market players, and the mortgage insurance industry. Representatives of the financial regulatory agencies, including the OCC, attended the roundtable as observers.

Through these discussions we have learned that some bankers and community groups do indeed find that the requirements of secondary mortgage market participants and mortgage insurers are sometimes an obstacle to urban housing lending and the fulfillment of housing investment agreements. According to some bankers, some banks that originate mortgage loans secured by property in urban areas are holding those loans in port-

folio because of their inability to sell them in the secondary market.

The OCC has not discussed these concerns directly with the secondary market corporations. In the absence of direct evidence of national bank noncompliance with applicable laws, a regulatory solution would not be an appropriate way to address this issue. Rather, private initiatives, such as the recent ABA-ACORN roundtable, are an appropriate way for interested parties to discuss the issue and explore ways to address their mutual concerns.

VI. Summary and Conclusion

The OCC has developed a comprehensive program to ensure that national banks meet the credit needs of their local community. We maintain extensive contacts with community and banking groups to ensure that all parties understand the needs and resources of each other. We use on-site examination program designed to ensure that national banks comply with the law. We offer our examiners specialized training to ensure our own ability to assess accurately national banks' compliance efforts and accomplishments. We consider the results of our assessments in evaluating corporate applications and have, at our own initiative, caused national banks to strengthen their CRA performance.

Most national banks meet the credit needs of their local communities in the ordinary course of doing business. The OCC has not found it necessary to deny many applications on CRA grounds — only four since 1979. Denials are a last resort. They are used only when the far more effective tactic of conditional approval has little, if any, chance of modifying bank performance.

Remarks by J. Michael Shepherd, Senior Deputy Comptroller for Corporate and Economic Programs, before the Association of Bank Holding Companies, Washington, D.C., March 25, 1988

The Revised Risk-Based Capital Proposal

The Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Board of Governors of the Federal Reserve System, have jointly developed a risk-based capital proposal which was published in the *Federal Register* on Tuesday, March 15. The proposal is based on the framework for international capital standards established in December by the BIS Com-

mittee on Banking Regulations and Supervisory Practices (otherwise known as the Cooke Committee).

We encourage you to look carefully at the proposed guidelines and to comment on issues that you believe to be important, including transition roles, application to classes of banks, and weighting. The comment closes on May 13. (Published on the Ides of March, comments close on Friday the 13th!) This summer, the Cooke Com-

Committee will meet again to consider any modifications to the alternative framework. After that, the U.S. agencies will prepare the final guidelines.

Before discussing the revised risk-based capital proposal, which I'll refer to as the "U.S. Proposal," let me step back and discuss some of the factors that motivated it.

Flaws in the Existing Capital Standard

We believe that the current capital standard, which bases a bank's required capital on the volume of its assets, has several flaws.

First, it fails to differentiate between high risk and low risk assets. For example, Treasury obligations and loans to unrated commercial borrowers require identical capital. Both the primary and total capital ratios use the volume of total assets as a proxy for the amount of risk a bank faces. This is obviously a very crude measure of risk, since assets may vary widely in their risk characteristics.

The second flaw in the current standard is that it does not require capital against off-balance sheet activities. Off-balance sheet activities have been an area of rapid growth; and by definition, the total assets measure does not include such items. Yet these activities can expose banks to credit risk in much the same way as on-balance sheet assets.

The third flaw in the existing capital standard is that neither the minimum required capital ratio nor the definition of capital is uniform internationally. The lack of a uniform definition of capital has made it difficult to compare capital levels among different countries and has led to frequent complaints about unequal competition in international banking markets.

The U.S. Proposal, like the Cooke Committee framework on which it is based, is a modest attempt to mitigate some of the shortcomings of the existing standard. The proposed guidelines make three basic improvements in the capital standard.

- They recognize differences in the riskiness of assets by discounting capital requirements for assets that have less credit risk.
- They recognize the risk inherent in some off-balance sheet activities by requiring that banks hold capital against them.
- They establish a definition of capital and a minimum capital standard that is consistent internationally.

Let me describe now in greater detail the three areas in which the U.S. Proposal differs from the existing capital standard.

Assets Are Risk Weighted

First, assets are placed into one of five categories, based primarily on perceived credit risk.

To calculate a bank's minimum capital requirement, the face value of assets in each category is adjusted to reflect the relative riskiness of that category. For example, assets in the first category — consisting of cash, reserves at the Fed, and short-term U.S. Government securities — are viewed as being essentially riskless and, therefore, require no capital.

Capital is required against assets in the remaining four categories. Capital would be required against 10, 20, 50, or 100 percent of the assets' face value, depending on the particular category. The upshot of this is, for example, that an asset with a risk weight of 10 percent would require only one-tenth the capital support required for an asset weighted 100 percent.

I've included the asset risk weights from the U.S. Proposal in Table 1. Several of the asset weights are worth nothing.

Broad discretion was given by the Cooke Committee on the appropriate risk weight for claims on the central government. The Committee proposed that such assets be placed into the 0, 10, or 20 percent risk categories.

The U.S. Proposal assigns direct and indirect claims on the federal government to the 10 percent category. As an exception to this, the agencies are proposing that direct claims on the U.S. Government and its agencies be placed in the 0 percent category if they have a remaining maturity of 91 days or less. The U.S. agencies' earlier proposals assigned weights to claims on the U.S. Government ranging from 10 percent to 25 percent. Because they lack the full faith and credit backing of the Federal government, direct and indirect claims on U.S. Government-sponsored agencies will be assigned to the 20 percent risk category. This compares to the 50 percent category in the earlier proposals of the U.S. agencies.

The Cooke Committee also left domestic supervisors a wide choice on the weighting of domestic, non-central government debt — ranging from 0 to 50 percent. In that context, some weights have been lowered.

The U.S. proposal maintains the distinction, made in earlier proposals, between general obligation debt, backed by the full faith and credit of the local taxing autho-

ity, and public purpose debt which is to be serviced purely out of the revenues of the project being financed. The proposed treatment is, however, somewhat more liberal than that accorded these assets by earlier proposals of the U.S. agencies. General obligations will be placed in the 20 percent risk category, rather than in the 50 percent; and other public purpose debt will be placed in the 50 percent category, rather than in the 100 percent. Private purpose debt of states, counties, or municipalities — such as industrial development bonds — will continue to be placed in the 100 percent category.

In accordance with the Cooke Committee framework, short-term claims on U.S. depository institutions and on foreign banks are now assigned a risk weight of 20 percent, rather than 25 percent, as before, (indeed, the 25 percent category was eliminated) and long-term claims on U.S. depository institutions have been moved from the 100 percent risk category to the 20 percent category. Further, assets guaranteed by domestic banks will now be assigned a 20 percent risk weight.

Finally, although loans for owner-occupied residential real estate are assigned a 50 percent risk weight in the Cooke Committee framework, the U.S. agencies have assigned such loans to the 100 percent category. We assign them a 100 percent risk weight primarily for two reasons. First, while real estate may generally be a sound form of collateral, from a supervisory perspective, its value is more difficult to ascertain than the other forms of collateral recognized by the Proposal. Second, giving special treatment to real estate loans — especially when we do not do so for triple-A private borrowers — would add fuel to the criticism that the risk-based capital proposal is an attempt by the banking agencies to engage in credit allocation.

Off-Balance Sheet Activities Are Included

The second change from the existing capital standard is that the risk-based capital ratio takes into account the credit risk exposure that results from off-balance sheet activities. Because of their contingent nature, off-balance sheet items will be treated a bit differently than balance sheet assets.

The face value of each off-balance sheet instrument will be converted into terms equivalent to the credit exposure on a loan to the same obligor. For example, a standby letter of credit serving as a financial guarantee, which exposes a bank to credit risk in the same manner as a loan, will be assigned a conversion factor of 100 percent. Other off-balance sheet instruments entail less credit risk and, therefore, will be assigned lower conversion factors — some as low as 0 percent.

The credit equivalent amount is subsequently placed into

one of the five risk categories based upon the type of instrument, obligor, collateral, or guarantee that is involved. Thus, for example, an off-balance sheet item with a credit conversion factor of 50 percent issued to an obligor who falls into the 50 percent risk category would require capital against 25 percent of the dollar amount of the item.

The U.S. banking agencies have followed the Cooke Committee framework in the credit conversion factors applied to off-balance sheet items. This has caused two changes from the U.S. agencies' earlier proposals. The conversion factor for short-term commitments has been reduced from 10 to 0 percent. This applies to the unused portions of credit card lines, if they are cancelable by the bank, without cause, at any time. The other change is that, because of their short-term, self-liquidating nature, commercial letters of credit have been assigned a conversion factor of 20 percent, rather than the former 50 percent.

The credit conversion factors proposed by the banking agencies are listed in Table 2.

With regard to another class of off-balance sheet activity, the Cooke Committee proposed two options for incorporating the credit risk of interest and exchange rate contracts into the risk-based capital ratio. Table 3 shows the method that the U.S. banking agencies are proposing to use. This method is conceptually similar to what was proposed by the Board of Governors early last year, but will result in a significant reduction in the capital required for such instruments.

Table 4 provides a sample calculation of the risk-based capital ratio.

Capital Is Redefined

The third area of change under the proposed risk-based capital standard involves the redefinition of capital. Table 5 lists the elements of capital as defined in the U.S. Proposal. Capital instruments are placed in two tiers.

Tier 1 will include common equity and minority interests in consolidated subsidiaries. Tier 2, which will be limited to 100 percent of Tier 1 capital, will include, among other items, preferred stock, mandatory convertible securities, subordinated debt, and the allowance for loan and lease losses.

Tier 2 capital elements will qualify as part of a bank's total capital base up to a maximum of 100 percent of that bank's Tier 1 capital. Some of the elements of Tier 2, however, will be subject to additional sub-limits. These include the loan loss reserve, which will be limited to 1.25 percent of risk-weighted assets, and term subordinated

debt and nonconvertible term, limited life preferred stock which will be subject to a maximum limit of 50 percent of Tier 1 capital. Moreover, these latter instruments will be amortized during the final 5 years of their term to maturity.

Further, some assets will be deducted from capital under the proposed redefinition. These include goodwill, except in the case of some failed institution acquisitions, majority investments in unconsolidated banking or finance subsidiaries, and reciprocal holdings of other banks' capital instruments.

While the U.S. Proposal does not explicitly deduct investments in other unconsolidated subsidiaries — joint ventures or subsidiaries engaged in businesses other than banking or finance — from capital, such investments will be considered on a case-by-case basis and may be deducted in part or in whole.

Finally, the Cooke Committee framework allows revaluation reserves for unrecognized gains on securities holdings and on bank premises to be included in Tier 2. While in some countries such reserves are widely regarded as legitimate components of a bank's net worth, this has traditionally not been either the regulatory or the accounting practice in the United States. The U.S. banking agencies have, therefore, proposed that such reserves not be included in the regulatory definition of capital.

The Minimum Capital Requirement

Under the U.S. Proposal, banks will be required to have a risk-based capital ratio of at least 8 percent by yearend 1992. Half of this capital will have to qualify as Tier 1 capital.

The U.S. supervisory agencies will begin to phase in the new requirements as of December 31, 1990. During the phase-in period, exceptions to the limitations on the use of Tier 2 capital instruments will be allowed. In addition, some elements of capital will be grandfathered during the transition.

The existing capital-to-total-assets requirements will remain in effect at least until the end of 1990. By that time, the U.S. agencies will decide whether to operate the risk-based guidelines in tandem with some minimum capital-to-total-assets ratio. Such a minimum ratio, if used, would be based on the new definition of capital and set at an as yet undetermined level.

Remaining Steps in the Process

The following steps remain before the new risk-based capital standard can be put into effect:

- The U.S. agencies will review the comments they are currently receiving and will determine whether to recommend that changes be made in the Cooke Committee's Proposal.
- The Cooke Committee will meet, probably in July, to consider whether to make revisions to its proposal. It will publish a final international standard sometime thereafter.
- The U.S. agencies will then determine whether changes should be made to the U.S. Proposal, either because of revisions made by the Cooke Committee in its international framework or as a result of comments received on the U.S. Proposal. The U.S. agencies will then publish the final version of the new capital guidelines, possibly by late 1988.

An Area of Special Concern

A likely concern of this audience is the effect the new guidelines will have on mergers and acquisitions.

In approving mergers and acquisitions that do not raise antitrust concerns, the most important factor considered by bank regulators today is the capital adequacy of the proposed combination. This will remain so under the new risk-based capital guidelines.

It is too early to determine what the effects of the new capital standard will be on merger activity. Our estimates are that few banks will be required to raise capital; the proposal is expected to be — in the tax reform parlance — "revenue neutral." Nonetheless, some banks will find that they do not meet minimum capital standards under the new guidelines.

We estimate that, on average, multinational banks will have lower Tier 1 capital ratios than their primary ratios under the current rules. This group of banks has an average primary capital ratio of 7.36 percent, which is well above the existing regulatory minimum. The multinational banks, however, are estimated to have an average risk-adjusted Tier 1 capital ratio of slightly less than the 4 percent minimum required level. This difference implies that at least some of these banks will have to slow their expansion plans, make adjustments to their asset portfolios, or raise new Tier 1 capital.

In contrast, under the new guidelines, many regional and community banks will find themselves in a stronger capital position. As a result, depending on any tandem requirements, they may be able to pursue a more aggressive program of acquisitions than under the old capital rules.

The treatment of intangibles in the new capital guidelines is not likely to affect the structure or number of mergers

and acquisitions at the holding company level. Although the Fed currently permits holding companies to include tangibles in their capital, it focuses on tangible capital when considering applications for acquisitions. It will continue to do so under the new guidelines.

Conclusion

The OCC is pleased that the process of achieving both international and domestic agreement on capital standards has progressed this far. Once the proposal is published, I would certainly encourage all of you to participate in the comment process. Feedback from the industry is very useful, and has led to several changes in the U.S. Proposal.

In conclusion, we realize that the proposal is not perfect. We do believe, however, that it represents a substantial improvement over the current capital adequacy standard, particularly to the extent that a significant degree of international convergence in capital adequacy standards has been achieved. To paraphrase a colleague at the Bank of England, while it may not completely level the international playing field, it does smooth out some of the larger bumps.

Table 1

Summary of Risk Weights and Risk Categories.

Category 1: Zero Percent

1. Cash (domestic and foreign)
2. Balances due from, and claims on, Federal Reserve Banks.
3. Securities (direct obligations) issued by the U.S. Government or its agencies with a remaining maturity of 91 days or less.*

Category 2: 10 Percent

1. Securities issued by the U.S. Government or its agencies with remaining maturities of over 91 days and all other claims (loans and leases) on the U.S. Government or its agencies.*
2. Securities and other claims guaranteed by the U.S. Government or its agencies (including portions of claims guaranteed).

*For the purpose of calculating the risk-based capital ratio, a U.S. Government agency is defined as an instrumentality of the U.S. Government whose obligations are fully and explicitly guaranteed as to the timely repayment of principal and interest by the full faith and credit of the U.S. Government.

3. Portions of loans and other assets collateralized by securities issued by, or guaranteed by the U.S. Government or its agencies, or by cash on deposit in the lending institution ***
4. Federal Reserve Bank Stock

Category 3: 20 Percent

1. All claims (long- and short-term) on domestic depository institutions.
2. Claims on foreign banks with an original maturity of 1 year or less.
3. Claims guaranteed by, or backed by the full faith and credit of, domestic depository institutions.
4. Local currency claims on foreign central governments to the extent the bank has local currency liabilities in the foreign country.
5. Cash items in the process of collection.
6. Securities and other claims on, or guaranteed by U.S. Government-sponsored agencies (including portions of claims guaranteed).***
7. Portions of loans and other assets collateralized by securities issued by, or guaranteed by, U.S. Government-sponsored agencies.****
8. General obligation claims on, and claims guaranteed by, U.S. state and local governments that are secured by the full faith and credit of the state or local taxing authority (including portions of claims guaranteed).
9. Claims on official multilateral lending institutions or regional development institutions in which the U.S. Government is a share holder or a contributing member.

Category 4: 50 Percent

1. Revenue bonds or similar obligations, including loans and leases, that are obligations of U.S. state or local governments, but for which the government entity is committed to repay the debt only out of revenues from the facilities financed.

**Degree of collateralization is determined by current market value
 ***For the purpose of calculating the risk-based capital ratio, a U.S. Government-sponsored agency is defined as an agency originally established or chartered to serve public purpose specified by the U.S. Congress but whose obligations are not explicitly guaranteed by the full faith and credit of the U.S. Government
 ****Degree of collateralization is determined by current market value

2. Direct credit substitutes (general guarantees of indebtedness and guarantee-type instruments, including standby letters of credit serving as financial guarantees for, or supporting, loans and securities).

Category 5: 100 Percent

- 1. All other claims on private obligors.
- 2. Claims on foreign banks with an original maturity exceeding one year.
- 3. Claims on foreign central governments that are not included in item 4 of Category 3.
- 4. Obligations issued by state or local governments (including industrial development authorities and similar entities) repayable solely by a private party or enterprise.
- 5. Premises, plant, and equipment, other fixed assets; and other real estate owned.
- 6. Investments in any unconsolidated subsidiaries, joint ventures, or associated companies — if not deducted from capital.
- 7. Instruments issued by other banking organizations that qualify as capital.
- 8. All other assets (including claims on commercial firms owned by the public sector).

Table 2

Credit Conversion Factors for Off-Balance Sheet Items

100 Percent Conversion Factor

- 1. Direct credit substitutes (general guarantees of indebtedness and guarantee-type instruments, including standby letters of credit serving as financial guarantees for, or supporting, loans and securities).
- 2. Acquisitions of risk participations in bankers acceptances and participations in direct credit substitutes (e.g., standby letters of credit).
- 3. Sale and repurchase agreements and asset sales with recourse, if not already included on the balance sheet.
- 4. Forward agreements (that is, contractual obligations) to purchase assets, including financing facilities with certain drawdown

50 Percent Conversion Factor

- 1. Transaction-related contingencies (e.g., bid bonds,

performance bonds, warranties, and standby letters of credit related to a particular transaction).

- 2. Unused commitments with an original maturity exceeding one year, including underwriting commitments and commercial credit lines.
- 3. Revolving underwriting facilities (RUFs), not issuance facilities (NIFs) and other similar arrangements.

20 Percent Conversion Factor

- 1. Short-term, self-liquidating trade-related contingencies, including commercial letters of credit.

Zero Percent Conversion Factor

- 1. Unused commitments with an original maturity of 1 year or less or which are unconditionally cancellable at any time.

Table 3

Treatment of Interest Rate and Exchange Rate Contracts

The Current Exposure Method (described below) will be utilized to calculate the “credit equivalent amounts” of these instruments. These amounts may be assigned a risk weight appropriate to the obligor or any collateral or guarantee. However, the maximum risk weight will be limited to 50 percent.

<i>Residual Maturity</i>	<i>Interest Rate Contracts</i>	<i>Exchange Rate Contracts</i>
Less than 1 year	mark-to-market (MM)	MM + 1.0% of total notional principal (NP)
One year and over	MM + 0.5% of NP	MM + 5.0% of NP

The following instruments will be excluded:

- Exchange rate contracts with an original maturity of 7 days or less, and
- Instruments traded on exchanges and subject to daily margin requirements.

Table 4

Sample Calculation of Risk-Based Capital Ratio

Example of a bank with \$6,000 in total capital and the following assets and off-balance sheet items:

Balance Sheet Assets

Cash	\$ 10,000
Long-term U.S. Government Securities	20,000
Balance at domestic banks	5,000
Loans to private corporations	<u>65,000</u>
Total Balance Sheet Assets	\$100,000

Off-Balance Sheet Items

Standby letters of credit ("SLCs") backing general obligation debt issues of U.S. municipalities ("GOs")	\$10,000
Long-term commitments to private corporations	<u>20,000</u>
Total Off-Balance Sheet Items	\$30,000

This bank's total capital to total assets ratio would be:

$$(\$6,000/\$100,000) = 6.00\%$$

To compute the bank's weighted risk assets:

1. Compute the credit equivalent amount of each off-balance sheet ("OBS") item.

<u>OBS Item</u>	<u>Face Value</u>		<u>Conversion Factor</u>		<u>Credit Equivalent Amount</u>
SLCs backing municipal GOs	\$10,000	x	1.00	=	\$10,000
Long-term commitments to private corporations	20,000	x	0.50	=	\$10,000

2. Multiply each balance sheet asset and the credit equivalent amount of each OBS item by the appropriate risk weight.

0% Category

Cash	\$10,000	x	0	=	\$0
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10% Category

Long-term U.S. Government securities	\$20,000	x	0.10	=	\$2,000
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20% Category

Balances at domestic banks	5,000				
Credit equivalent amounts of SLCs backing GOs of U.S. Municipalities	<u>10,000</u>				
	\$15,000	x	0.20	=	\$3,000

50% Category

No items

100% Category

Loans to private corporations	\$65,000				
Credit equivalent amounts of long-term commitments to private corporations	<u>10,000</u>				
	\$75,000	x	1.00	=	<u>\$75,000</u>

Total Risk-Weighted Assets	\$80,000
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This bank's risk-based capital ratio would be:

$$(\$6,000/\$80,000) = 7.50\%$$

Table 5

Proposed Definition of Capital

Capital will be composed of two parts (Tiers 1 and 2). Beginning December 31, 1992, all national banks will be expected to maintain a capital to risk-weighted asset ratio of 8.0 percent of which at least half must consist of Tier 1 capital. In other words, Tier 2 capital elements will qualify as part of a bank's total capital base up to a maximum of 100 percent of that bank's Tier 1 capital.

Definition of Capital

Tier 1:

- common stock,
- surplus,
- undivided profits and capital reserves, and
- minority interests in consolidated subsidiaries.

Tier 2:

- perpetual and long-term preferred stock,
- perpetual and other hybrid debt/equity instruments,
- intermediate-term preferred stock and term subordinated debt (to a maximum of 50% of Tier 1 capital), and
- loan loss reserves (to a maximum of 1.25% of risk-weighted assets).

Deductions from Capital:

- all intangibles except mortgage servicing rights (supervisory exceptions may also be made for goodwill);
- investments in unconsolidated banking and finance subsidiaries, and
- reciprocal holdings of the capital instruments of other banks.

Transitional Definition

During a transition period beginning December 31, 1990, all national banks are expected to maintain a capital to

risk-weighted asset ratio of 7.25 percent, of which at least 3.25 percentage points must consist of Tier 1 capital. In other words, during this period up to 4 percentage points of the 7.25 capital ratio may consist of Tier 2 capital. Also

during this period, the sublimit on limited-life preferred stock and subordinated debt will not be enforced, while that on loan loss reserves will be 1.5 percent of risk-weighted assets.

Interpretive Letters—January through March 1988

	<i>Letter No.</i>
Laws	
12 U.S.C. 24 (7)	397, 398, 399, 401, 406, 410, 411, 413, 414, 415, 416, 417, 419
12 U.S.C. 29	399
12 U.S.C. 36	403, 418
12 U.S.C. 62	405
12 U.S.C. 78	406, 407, 408, 411
12 U.S.C. 84	400, 410, 411, 412
12 U.S.C. 92a	402
12 U.S.C. 221	403, 411
12 U.S.C. 371	417
12 U.S.C. 371c	399, 403, 412
12 U.S.C. 377	411
12 U.S.C. 378	417
12 U.S.C. 1843	401
12 U.S.C. 3201 <i>et seq.</i>	409
15 U.S.C. 77b(1)	414
Regulations	
12 C.F.R. 5.34	397, 398, 403, 411, 415, 416, 418, 419
12 C.F.R. 7.5217	404
12 C.F.R. 7.5220	401
12 C.F.R. 7.7016	412
12 C.F.R. 7.7115	401
12 C.F.R. 9.18	413
12 C.F.R. 26	409
12 C.F.R. 29	396
12 C.F.R. 32	412
12 C.F.R. 32.2	400
12 C.F.R. 34	417

I am writing in response to your letters of April 23, July 17, and November 6, 1986, to Attorney James E. Orie of our Southeastern District Office in Atlanta. Mr. Orie referred your question to this office, and he requested that I reply directly to you. You wished to know whether the Comptroller's adjustable-rate mortgage (ARM) regulation, 12 C.F.R. Part 29, would apply to a certain lending transaction. My conclusion is that it does.

The factual background, as you have described it, is as follows:

Our bank client has closed a \$2,000,000.00 line of credit loan to an individual commercial borrower, the proceeds of which are intended to be used by the borrower either: (i) to construct and/or renovate improvements on existing single family residential properties owned by the borrower for the purpose of resale or (ii) to acquire additional residential properties for purposes of renovation and resale. The loan has been initially secured by two existing residential properties owned by the borrowers and, therefore, none of the loan proceeds advanced to date have been used to acquire any residential properties; however, as the existing properties are renovated and sold, it is contemplated that the borrower will use advances under the line of credit to acquire other residential properties for purposes of renovation and resale.

The interest rate applicable to the subject loan is based upon our bank client's prime rate. All of the residential properties are contemplated to be in the "luxury" class (i.e., \$500,000.00 and above) and will be non-owner occupied. During the term of the line of credit, it is contemplated that the borrower will acquire and resell more than four single family residential properties; however, at any one time, the loan may be secured by less than four single family residential properties. In addition to the single family residential properties, the loan is also secured by other collateral of the borrower.

You apparently discussed with Mr. Orie the idea that this transaction should be exempt from the ARM regulation because it is analogous to a construction loan to a builder/developer who is building homes for resale. However, I cannot agree with this conclusion.

An adjustable-rate mortgage loan subject to the ARM regulation is defined as follows:

An adjustable-rate mortgage loan is any loan made to finance or refinance the purchase of and secured by a lien on a one- to four-family dwelling, includ-

ing a condominium unit, cooperative housing unit or a mobile home, where such loan is made pursuant to an agreement intended to enable the lender to adjust the rate of interest from time to time 12 C.F.R. § 29.1.

The Office has held that the ARM regulation does not apply to loans to builders or real estate developers for the purpose of constructing and selling housing units. See, e.g., Interpretive Letter No. 234, [1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,315 (December 17, 1981); Interpretive Letter No. 207, *id.* ¶ 85,288 (June 19, 1981); preamble to ARM regulation amendments, 48 Fed. Reg. 9506; 9508 (1983). These sources cite the following reasons for the "construction loan exemption:"

- The loan is made to finance the working capital needs of a construction business rather than the purchase of a dwelling.
- The expected source of repayment is the contemplated sale of the finished houses [rather than the income of the borrower].
- The builder or developer intends to resell the structure as soon as the construction is completed.

Your position, as I understand it, is that the same factors apply to the loan which your client has made, and it should therefore also be exempt. However, there is one crucial difference, and that is, your client's borrower is using part of the loan proceeds to purchase dwellings. This brings the loan squarely within the language of the definition of 12 C.F.R. § 29.1. In my opinion, the fact that a dwelling is not being purchased is the true and only reason for exempting construction loans. The other factors listed above may be descriptive of construction loans, but they do not account for the exemption.

The fact that a construction loan provides working capital for a business merely goes to the point that the loan is not used to purchase a dwelling. This is demonstrated by the fact that construction loans to individuals who build their own homes are also exempt from the ARM regulation, if a binding takeout commitment is present. Interpretive Letter no. 234, *supra*; *Federal Register* preamble, *supra*. The rationale is that the permanent financing or takeout commitment is the loan which is used to purchase the dwelling; the construction loan goes instead for the purchase of materials, labor, etc. In such a case, no business working capital is involved. Therefore, the fact that your client's loan provides working capital for the borrower is irrelevant, because the borrower's working capital is used to purchase dwellings.

397—September 15, 1987

Mr. John H. Huffstutler
Assistant General Counsel
Legal Department
World Headquarters
Bank of America National Trust
and Savings Association
Bank of America Center
Box 37000
San Francisco, California 94137

Dear Mr. Huffstutler:

This is in further response to your notification of July 22, 1987, concerning Bank of America's (Bank) intent to establish and cause one or more wholly owned operating subsidiaries to enter into general or limited partnerships with depository or nondepository co-lenders solely for the purpose of acquiring, managing and liquidating assets acquired in satisfaction of debts previously contracted by the Bank (DPC assets). Our July 28 response permitted one of your existing operating subsidiaries to participate as a general partner in a partnership with other bank subsidiaries and the FDIC to deal with DPC assets acquired in connection with one particular syndicated loan.

The operating subsidiary regulation generally requires that notice be given when a bank desires to establish or acquire or perform new activities in a subsidiary. 12 C.F.R. § 5.34(d)(1). However, 12 C.F.R. § 5.34(d)(1)(iii) states:

A bank may establish or acquire an operating subsidiary without notifying the Office provided: (A) the activities of the new subsidiary are limited to those activities previously reported by the bank in connection with the establishment or acquisition of a prior operating subsidiary; (B) the establishment or acquisition of the prior subsidiary was considered permissible by the Office; and (C) the activities in which the new subsidiary will engage continue to be considered legally permissible by the Office.

There are two related questions which must be answered in order to fully respond to your notification. First, would the establishment or acquisition of a new operating subsidiary to deal with the Bank's DPC assets satisfy the conditions in 12 C.F.R. § 5.34(d)(1)(iii)? Second, with respect to an already existing operating subsidiary, would the alteration of an existing DPC assets partnership or the entry into a new DPC assets partnership constitute a new activity by the subsidiary within the meaning of 12 C.F.R. § 5.34(d)(1)(i)? As explained more fully below, it is my opinion that the Bank need not give notice pursuant to 12 C.F.R. 5.34(d)(1)(i) in order to establish or acquire a new operating subsidiary to deal with the Bank's DPC assets

The borrower's expected source of repayment is also irrelevant in determining the applicability of the ARM regulation. Nowhere in the regulation is the source of repayment made a criterion and when the issue was presented, the Office held that the expected source of repayment makes no difference. Interpretive Letter No. 240, [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,404 (March 9, 1982).

Similarly, the Office has long held that the borrower's reason for purchasing the property is not a factor in applying the ARM regulation.

It is not the investment or other intent of the borrower, but rather the fact that a loan is made to finance or refinance the purchase of property of the type described in the definition, which determines the applicability of the regulation.

(Interpretive Letter No. 210, [1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,291 (August 11, 1981).) The regulation is intended to afford protection to both small investors and individuals purchasing property for their own use. Interpretive Letter No. 223, *id.* ¶ 85,314 (December 11, 1981).

In 1984, the Office considered a factual situation closely resembling the one which you have presented. In that case, the borrower intended to renovate and resell an existing one- to four-family dwelling. It was determined that the ARM regulation would not be applicable if the entire loan was to be used for renovation, but that if any portion of the loan was used to purchase the dwelling, the regulation would apply. In other words, an adjustable-rate mortgage loan which is used to both purchase and renovate an existing one- to four-family home for subsequent resale is within the ambit of 12 C.F.R. Part 29. Interpretive Letter No. 307, [Current] Fed. Banking L. Rep. (CCH) ¶ 85,477 (August 27, 1984). It is my opinion that the same conclusion applies to your client's loan, assuming that it finances the purchase of no more than four housing units at one time. The ARM regulation does not apply to loans which finance the purchase of more than four units at the same time. In that case, the lending bank is free to aggregate all units being financed with a single credit line, regardless of whether the units are physically connected or not. Interpretive Letter No. 340, *id.* ¶ 85,511 (May 22, 1985).

I trust this has been responsive to your inquiry. If you have additional questions, please feel free to contact Christopher Manthey at (202) 447-1880.

Peter Webesman
Assistant Director
Legal Advisory Services Division

. . .

or to alter an existing or enter a new DPC assets partnership with an existing operating subsidiary. In other words, the Bank's July 22, 1987 proposal is legally permissible and notification need not be repeated so long as the DPC assets being acquired, managed, and disposed by a Bank operating subsidiary stem from the Bank's own lending activity.

Your proposal involves the creation of one or more operating subsidiaries to deal with the Bank's DPC assets. Although presumably a new operating subsidiary would deal with new DPC assets, *i.e.*, assets stemming from a different loan, this should not disqualify the new subsidiary from being engaged in "activities previously reported" as that phrase is used in 12 C.F.R. § 5.34(d)(1)(iii). In short, the collateral may change but the activity remains the same, the orderly acquisition, management and disposition of assets obtained by the Bank pursuant to a defaulted or foreclosed loan.

Nor do I believe that the entry by an existing operating subsidiary into a new DPC assets partnership, presumably with new co-lenders, would constitute the performance of "new activities" within the meaning of the general notification requirement in 12 C.F.R. § 5.34(d)(1)(i). Again, the activity remains the orderly acquisition, management and disposition of DPC assets stemming from Bank loans. This represents a change from the position articulated in OCC Staff Interpretive Letter No. 355, by Patriarca, Dec. 10, 1985, *reprinted* in [Transfer Binder 1985-1987] Fed. Banking L. Rep. ¶ 85,525 (CCH), which approved a bank's establishment of an operating subsidiary to enter into a general partnership with the subsidiaries of three other bank co-lenders to hold and dispose of DPC assets acquired in connection with a syndicated, foreclosed loan. That letter stated towards the end:

The Office believes that the nature and structure of a partnership, as well as the activities in which it is engaged are necessary factors in the legal and supervisory assessment of national bank involvement. Accordingly, changes in the activities of the partnership, changes in the bank's proportion of interest in the partnership, material changes in the provisions of the partnership agreement, and changes in the identity of other partners are considered new activities of the operating subsidiary for purposes of the notification requirement of 12 C.F.R. § 5.34(d)(1). Similarly, the formation of other, new partnerships to dispose of other assets are also considered new activities for notification purposes.

Since December 1985 the OCC has considered several operating subsidiary partnership programs. Particularly where a national bank operating subsidiary proposes to be a partner with other partners which are not deposi-

tory institutions, our level of concern and caution remains high. This is in large part due to the need to be certain that the partnership business engages and will engage solely in authorized banking conduct.

But the Bank's proposal is limited to dealing with DPC assets acquired in connection with the Bank's own defaulted or foreclosed loans. This is clearly a permissible activity regardless of whether the Bank was the sole lender or was a co-lender with one or more other depository or nondepository institutions. It is therefore unnecessary, in my opinion, for the Bank to provide additional notices in connection with future operating subsidiary DPC assets transactions. This includes the formation of new co-lender partnerships to hold and dispose of DPC assets.

We do believe that certain conditions must be satisfied going forward. Any Bank operating subsidiary dealing with DPC assets should be adequately capitalized in relation to the DPC assets in question and the anticipated expenses associated with the acquisition, management and disposition of the assets. Any partnership venture entered into must be subject to OCC examination and supervision as deemed appropriate by the Office, and by agreement the partnership must be limited to the acquisition, management, and disposition of the DPC assets. Partners should be limited to co-lenders and their agents. The DPC assets must of course be disposed of as soon as possible and within the guidelines applicable to national banks' DPC assets. See, *e.g.*, 12 U.S.C. §§ 24 (Seventh), 29 and cases thereunder; 12 C.F.R. §§ 7.3020, 3025; *Comptroller's Handbook for National Bank Examiners* § 219. Finally, the Bank must maintain at its headquarters office and make available to our examiners current information on all of its operating subsidiary DPC assets activities, including names and locations of each operating subsidiary, each partnership and agreement pertaining thereto, and each DPC asset being held pending disposition.

In sum your July 22, 1987 notification is sufficient to cover future DPC asset situations by existing or new Bank operating subsidiaries, including instances wherein the Bank subsidiary will be a general or limited partner with depository or nondepository co-lenders. The Bank remains responsible for assuring that all DPC asset activities are conducted in a safe and sound manner and in conformity with all pertinent laws and regulations.

J. Michael Shepherd
Senior Deputy Comptroller
for Corporate and Economic Programs

* * *

398—September 28, 1987

Jerrey S. Lillen
Senior Attorney
The First National Bank of Chicago
Chicago, Illinois 60670

Dear Mr. Lillen

This is in response to your letter of March 23, 1987, providing notification, as required by 12 C.F.R. § 5.34, of the intention to expand the activities of an existing operating subsidiary of your bank. Since the proposed activities are incidental to banking under 12 U.S.C. § 24 (Seventh), you may go forward with your plans.

First National Bank of Chicago (the Bank) formerly maintained a Corporate Security Section. By letter dated December 5, 1986, we approved the establishment of First Chicago Security Services, Inc. (the Subsidiary) as an operating subsidiary of the Bank. The Bank's internal security functions were then turned over to the Subsidiary. Certain other activities of the Corporate Security Section previously approved by this Office on June 6, 1986 (No Objection Letter No. 86-15, [Current] Fed. Banking L. Rep. (CCH) ¶ 84,021) were also transferred to the Subsidiary, i.e., providing security consulting services and leasing excess computerized security console capacity to unaffiliated financial institutions. You now propose to expand the Subsidiary's activities further by having it physically provide security and guard services at other banks and corporations owned by the Bank's parent holding company, First Chicago Corporation (the Holding Company). It is my understanding that these services will initially be provided at affiliate banks, and that later they will be expanded to nonbank companies with the Holding Company family. After the expansion is completed, approximately two-thirds of the Subsidiary's manpower will still be devoted to the Bank's own security needs.

Having the Subsidiary provide this service for affiliates of the Bank is permissible for three reasons. First, it is reasonable that the Holding Company family centralize its internal security in a single entity because it is an efficient way to utilize existing resources and expertise. This will essentially be an "in house" activity. Second, providing internal security to affiliated banks and nonbank companies within the Holding Company system is akin to other types of financial correspondent services we have approved as incidental to banking, such as courier service, tax preparation, and data processing. Third, since the majority of the Subsidiary's resources will still be devoted to the Bank, the extension of security services to affiliated companies can be viewed as a by-product of the permitted activity which is being performed for the Bank itself.

This Office has previously approved the use of one national bank to provide messenger service for other affiliate banks within the same holding company, letter of Deputy Comptroller Thomas G. DeShazo, April 26, 1974, and there is no reason why the same approval should not extend to security service.

The National Bank Act conveys upon national banks incidental powers which are necessary to carry on the business of banking, 12 U.S.C. § 24 (Seventh). One factor in deciding what is an incidental power is whether a proposed activity is similar to those traditionally performed by banks. Letter No. 137, [1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,218 (December 27, 1979). National banks have traditionally performed services for other banks, e.g., correspondent services, which are necessary for the efficient functioning of the banking system. Moreover, it is the Office's position that it is permissible for a bank to share with other financial institutions "the benefits of its experience in managing a bank, an activity which is central to banking." Letter No. 137, *supra*. Internal security is clearly an important aspect of the management and operation of a bank or other financial institution. Indeed, banks are specifically required to have adequate internal security by our regulations in 12 C.F.R. Part 21, which in turn are mandated by the Bank Protection Act, 12 U.S.C. §§ 1881 *et seq.*

For all these reasons, use of the Subsidiary to provide security services to other bank and nonbank subsidiaries of the Holding Company is hereby approved.

Emory W. Rushton
Deputy Comptroller for Multinational Banking

* * *

399—October 29, 1987

This is in response to your letter of February 26, 1987 to former Chief Counsel Richard V. Fitzgerald requesting approval of a proposal to lease lobby space in some of your subsidiary national banks to a travel agency. We have no objection to your plan, and I apologize for the delay in responding.

According to your letter, *** currently operates nine national banks and 20 state banks throughout Alabama. It proposes to form a travel agency as a subsidiary of one of the latter, which is permissible under the laws of Alabama. It then plans to lease three of its national banks, and possibly more. The space would be leased pursuant to a contract providing for a base rental fee and a percentage overage. You have asked for our approval of this proposal.

It is well established that national banks may, under 12 U.S.C. § 29 and 12 U.S.C. § 24 (Seventh), lease excess office space in bank-owned buildings. *Wirtz v. First National Bank & Trust Co.*, 365 F.2d 641 (10th Cir. 1966). Moreover, it is common for national banks to lease excess office space to a variety of tenants. Indeed, this Office has approved in the past a proposal very similar to yours, i.e., a national bank's leasing of branch space to a travel agency. Interpretive Letter No. 342, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,512 (May 22, 1985).

In that letter, the Office warned that the bank could not enter into a partnership or joint venture with the travel agency, and cautioned that an inference of partnership arises when the percentage required in a percentage leasing arrangement is too high. Accordingly, this Office advised the bank to include a clause in the leasing contract expressly precluding any bank liability for the lessee's debt and liabilities. In addition, the letter imposed the following requirements:

1. The nonbanking business should be appropriately and separately identified so that the public will understand that it is not buying the nonbanking service from the bank. Bank advertising and literature that mentions the nonbanking business should make clear the business' independent ownership and operations.
2. The relationship between the bank and the travel agency should be at arms-length, and the bank must ensure that tying arrangements involving the sale of travel agency services and the granting of credit, whether subtle or overt, will be avoided.
3. Bank management should consider security problems that may be presented by providing the public with access to the travel agency during hours when banking services are not also available.
4. To avoid conflict of interest and self-dealing problems, the bank should avoid leasing lobby space to an employee of the bank.

These conditions are equally applicable to your proposal, and in your letter you stated that they would be fully satisfied.

One aspect of your proposal which has not been presented to the Office previously is that the travel agency will be an affiliate of the national banks from which it leases space, by virtue of their common ownership by *** 12 U.S.C. § 371c(b)(1). The lease arrangement which you propose does not appear to be a covered transac-

tion which would be restricted by section 23A of the Federal Reserve Act, 12 U.S.C. § 371c(a). However, I call your attention to newly-enacted section 23B of the Federal Reserve Act, enacted as section 102(a) of the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 100 Stat.552. Assuming that a lease of floor space constitutes furnishing a service to the travel agency, section 23B(a)(1) requires that the arrangement be:

- (A) on terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to such bank or its subsidiary, as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies, or
- (B) in the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to, or would apply to, nonaffiliated companies.

Based on the facts you presented, national banks owned by *** may lease portions of their bank premises to the travel agency subject to the conditions and requirements outlined above. I hope that this has been responsive to your inquiry.

William B. Glidden
Assistant Director
Legal Advisory Services Division

* * *

400—November 9, 1987

I am writing in further response to your letter of March 27, 1986, addressed to our Western District Counsel, Joseph Pogar, Jr. Jonathan Rushdoony of Mr. Pogar's staff responded to your letter on April 8, 1986, and answered a number of questions which you raised. However, he forwarded your letter to me for consideration of the unanswered fourth question, and I am taking the liberty of responding to you directly.

The fourth question in your letter to Mr. Pogar reads as follows:

A bank has provided a line of credit to a customer which, during an examination, was found to be in excess of the bank's legal lending limit. Let us assume that the borrower has subsequently paid the loan below the bank's lending limit and wishes to borrow funds up to the bank's lending limit at a later date and continue to make use of his line of credit . . . Would the amount of the original classification remain a violation until the line is reduced to a zero balance?

It is my opinion that only the draw or draws which caused the total outstanding balance on the line of credit to exceed the bank's lending limit need be repaid in order to cure the violation of 12 U.S.C. § 84. However, liability of bank directors is a separate issue, and repayment of an amount equal to the excessive loan is not necessarily sufficient to eliminate such liability.

A "line of credit" is defined as

A pre-approved loan with a maximum amount of credit determined. The funds may be drawn against, repaid and redrawn at any time during the term of the agreement. Interest is calculated on the outstanding balance. (L. Batz, *Running Press Glossary of Banking Language* 49 (1977).)

The distinguishing feature of a line of credit is that the borrower can borrow repeatedly, within the limits of the line. As Mr. Rushdoony pointed out in his letter to you, the answer to your question depends on whether each of these borrowings is considered to be a separate and distinct loan, or whether they are merely parts of one loan to the borrower. If each draws against the line of credit is a separate loan, the bank would only need to obtain repayment of the advance or advances that caused the lending limit to be exceeded in order to correct the violation of section 84; but if each advance is part of the same loan, then the bank would be required to obtain repayment of all advances under the line of credit, reducing the outstanding balance to zero, in order to correct the lending limit violation.

Since its amendment in 1982, 12 U.S.C. § 84 has used the words "loans and extensions of credit" in prescribing the lending limits of national banks. These are defined as "all direct or indirect advances of funds to a person made on the basis of any obligation of that person to repay the funds or . . . any liability of a national banking association to advance funds to or on behalf of a person pursuant to a contractual commitment . . ." 12 U.S.C. § 84(b)(1). This definition is carried over in our lending limit regulations at 12 C.F.R. § 32.2(a). Thus, a loan exists if there is either an obligation on the part of someone to repay the bank, or a contractual commitment by the bank to make a loan.

The phrase "contractual commitment to advance funds" is defined in our regulations at 12 C.F.R. § 32.2(d). Although lines of credit are a type of contractual commitment to advance funds, the definition in Part 32 does not include them. Rather, it is limited to obligations which are in the nature of standby letters of credit, guarantees, or puts. Further the definition specifically states "For purposes of this part, undisbursed loan funds and loan commitments not yet drawn upon which are not equivalent to a contractual commitment to advance funds as defined

herein are not considered a contractual commitment to advance funds.' "

When the Office proposed implementing regulations to the amended section 84, 47 Fed. Reg. 56862 (1982), it specifically requested comments on whether fee paid commitments to lend or undisbursed loan funds should be considered contractual commitments to advance funds and, thus, loans or extensions of credit subject to the lending limits in section 84. The preamble to the final rule, 48 Fed. Reg. 15844 (1983), noted that 27 of the 37 commentors on this issue recommended that commitments not be subjected to the lending limit until funds were disbursed. These commentors asserted that bank internal controls to monitor disbursements of committed loans served as an effective constraint. The final rule, accordingly, does not treat undisbursed loan funds or loan commitments not yet drawn upon, and which are not equivalent to the defined type of loan commitment, as "contractual commitments to advance funds." 12 C.F.R. § 32.2(d). This accords with the Office' practice under the former version of 12 U.S.C. § 84, as well.

With a line of credit, the borrower does not have to use the entire amount at once, but may draw smaller sums repeatedly until the permitted maximum is reached. It could be argued that each draw is merely a separate installment of a single loan in the amount of the line of credit, or that the bank has constructively advanced all of the funds in a line of credit as soon as the borrower has made even a partial draw. However, the Office has not chosen these approaches under the existing regulation.

Therefore, under the present regulation, it is my opinion that each draw under a line of credit should be considered a separate, pre-approved loan at the time it is made. A line of credit is not a single loan unless the borrower draws down the entire amount at one time. It follows that when there is a violation of 12 U.S.C. § 84 involving a line of credit, only the amount of the draw or draws which caused the lending limit to be exceeded would be in violation of section 84.

The law is not settled on whether a violation of section 84 may be cured by merely repaying the overline portion of the loan resulting in the violation or whether the entire loan must be repaid. To avoid any issue, the Office usually recommends that the entire amount of the loan resulting in the overline be repaid; the bank may then loan additional funds up to the lending limit. For example, if a bank has a lending limit of \$100,000, and a line of credit borrower draws down \$75,000 and then \$50,000 at a later time, the violation of section 84 would be removed if the borrower repaid \$50,000, since that was the amount of the loan which caused the lending limit to be exceeded.

I must caution that correcting the violation of 12 U.S.C. § 84 and removing the liability of the bank's directors for the illegal loan are separate issues. Directors are potentially liable for loss incurred on a loan made in violation of section 84 even if the violation has been cured prior to the realization of the loss. It is the policy of the Office to apply loan payments to outstanding legal loans first, with illegal loans being paid down last. This would require that the entire outstanding amount of the credit line be paid down in order to eliminate the directors' liability. See *del Junco v. Conover*, 682 F.2d 1338 (9th Cir. 1982). In addition, directors of national banks are liable to shareholders at common law if they fail to use ordinary care and prudence in the administration of the bank's affairs, resulting in loss to the bank.

I trust that this has been responsive to your inquiry.

Peter Liebesman
Assistant Director
Legal Advisory Services Division

* * *

401—November 13, 1987

This responds to the questions that you raised in your May 21, 1987, letter and in your subsequent meeting with attorney Bruce Oliver of this Office and myself.

You indicated that you were concerned primarily with a situation that may arise where a national bank wishes to compensate a bank director with a deferred-fee program offered in combination with an obligation to pay a pre-retirement death benefit equal to the expected deferred fees. You ask whether the bank may purchase a single premium insurance policy on the life of the director in an amount sufficient to fund the bank's death benefit obligation and to return to the bank the amount of premium it paid, plus accrued interest.

We cannot, of course, endorse any insurance product, and your inquiry is of a rather general nature. Therefore, we respond by describing the general principles we apply when determining whether a national bank may lawfully engage in insurance activities similar to those you describe.

To begin, a national bank may purchase insurance where that purchasing is incidental to the business of banking. See 12 U.S.C. § 24 (Seventh). For example, a bank may purchase insurance to protect its interests, such as purchasing insurance on the life of a bank officer. See OCC Interpretive Ruling 7.7115, 12 C.F.R. § 7.7115. Similarly, a bank may purchase insurance to protect the interest that arises where the bank has a contractual obligation to pay a death benefit to the director's beneficiaries, so long as

the contractual obligation is permissible. A national bank may also purchase insurance as part of a compensation program. See OCC Interpretive Ruling 7.5220, 12 C.F.R. § 7.5220.

The amount of such insurance coverage must, of course, correspond to the amount of the bank's interest or be an appropriate part of a reasonable compensation package; the purchase of excessive insurance is not incidental to the business of banking. Note that we do not consider the payment of a life insurance premium to create an additional interest to the extent of the premium paid. Note too that we consider the amount of insurance coverage to be the total amount to be paid/received upon the death of the insured. With single premium universal life insurance, this would include the face amount of the death benefit, the return of the amount of premium paid, and accrued interest (e.g., where a bank pays \$30,000 for a policy that will provide a \$100,000 death benefit, plus a return of the amount of premium paid and accrued interest, we will consider the amount of insurance coverage to be \$130,000, plus accrued interest). Also a national bank may carry an insurance policy on the life of a director only so long as the bank continues to have a corresponding interest in the director's life. That is, when a director retires or resigns so that the director is no longer a key person and the bank is no longer obligated to pay a death benefit upon the director's death, the bank may no longer carry insurance to protect those interests.

You should also be aware that the insurance activity of national banks was recently a subject of the moratorium contained in the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 201, 100 Stat. 552, which prohibits this Office from issuing any rule, regulation, or order that would increase the insurance powers of national banks beyond those expressly authorized for bank holding companies under subparagraphs (A) through (G) of section 4(c)(8) of the Bank Holding Company Act of 1956 (codified at 12 U.S.C. § 1843(c)(8)(A) - (G)).

Finally, this Office will be concerned with a bank's concentration of assets in the cash surrender value of insurance policies issued by a single insurer, as a possible lack of risk diversification. Also, because of the importance of income tax considerations, we would counsel banks contemplating purchasing a single premium life insurance policy to seek the advice of competent tax counsel as to whether, or in what situations, benefits paid or cash withdrawals (or any portions thereof) may be taxable.

You have asked us also to reconsider our conclusion, in a letter to you of July 1987, that a national bank may not purchase a single-premium insurance policy on the life of a creditor of the bank's parent holding company, sell a portion of the policy to the holding company, and retain

the remaining portion. We continue to conclude that such a policy would likely be void under state law because the bank has no insurable interest in the life of the insured and that, in any case, the purchase of such an insurance policy would be an unauthorized investment by a national bank.

I trust that this has been responsive to your inquiry.

William B. Glidden
Assistant Director
Legal Advisory Services Division

* * *

402—December 1, 1987

I understand that your office is investigating matters which relate to certain trust activities which occurred in a national bank under the jurisdiction of this Office. For over twenty years I have served as Deputy Comptroller with responsibility for bank trust activities. To support you in your efforts, I thought it would be helpful to provide you with some background information on the criminal provision of 12 U.S.C. § 92a, which authorizes this Office to grant trust powers to national banks. This provision reads as follows:

It shall be unlawful for any national banking association to lend any officer, director, or employee any funds held in trust under the powers conferred by this section. Any officer, director, or employee making such loan, or to whom such loan is made, may be fined not more than \$5,000 or imprisoned not more than five years, or may be both fined and imprisoned, in the discretion of the court. (12 U.S.C. § 92a(h).)

Section 92a(h) originated as an amendment to the Federal Reserve Act. Act of September 26, 1918, ch. 177, § 2, 40 Stat. 968. The purpose of section 2 of the 1918 Act was to extend to national banks various fiduciary responsibilities previously allowed to state banks and trust companies. H.R. Rep. No. 479, 65 Cong. 2d Sess. 2 (1918). With respect to the criminal provision at issue, the House Report says only that "it shall be unlawful for a national bank to lend trust funds to any bank officer, director, or employee." Further, the provisions of section 2 are "intended to impose safeguards upon the exercise of these fiduciary powers by national bank." *Id.* at 3. The prohibition of the statute is clear: it is unlawful for a national bank to lend an employee any funds held in trust. *Busby v. Worthen Bank & Trust Co.*, 484 F Supp. 647, 651 (E.D. Ark. 1979).

In 1962 Congress decided to place responsibility for trust powers of national banks with the Comptroller of the Cur-

rency. In so doing, Congress retained the identical language of the original criminal provision. Act of September 28, 1962, Pub. L. No. 87-722, 76 Stat. 668. Prior to the 1962 legislation, the criminal provision had been codified at 12 U.S.C. § 248(k). The legislative history of the 1962 legislation does not refer to the criminal provision now located at section 92a(h). The meaning of the statute, however, is clear on its face — loans of bank trust funds to bank officers, directors and employees are illegal and punishable under the criminal laws. "Where the language is plain and admits of no more than one meaning the duty of interpretation does not arise . . ." 2A Sutherland Statutory Construction §46.01 (Sands 4th ed. 1984) (quoting *Caminetti v. United States*, 242 U.S. 470 (1917)).

This Office has a long history of consistent application of this statute, including the period prior to 1962 when it was part of the Federal Reserve Act. As early as 1942, this Office advised its examiners that violations of the statute would be referred to the Justice Department. Memorandum from T. V. Roberts, Assistant Counsel (June 26, 1942) ("The statute makes no provision for any exception in a case where the settlor of the trust directs a loan be made to an officer of the bank.'). Moreover, in view of the "absolute prohibition in that . . . criminal statute," loans to officers and employees cannot be justified. Letter from W. M. Taylor, Deputy Comptroller of the Currency (Feb. 25, 1959). Succeeding opinion letters have warned of referral to the Justice Department or reminded national bank officers that violations of the statute carry criminal penalties. See, e.g., Letter from W. M. Taylor (Feb. 3, 1960); Letter from Dean E. Miller, Deputy Comptroller of the Currency for Trusts, to all Trust Examining Personnel (April 1, 1963); Letter from Dean E. Miller (Jan. 23, 1969); Letter from J. T. Watson, Deputy Comptroller of the Currency (Mar. 31, 1975) (criminal referral to a United States Attorney); Letter from Dean E. Miller, Deputy Comptroller for Trusts and Securities (Mar. 18, 1986).

In addition, trust examiners are instructed as follows:

It should be noted that 12 U.S.C. §92a(h) makes no exceptions as to the lending of trust funds to officers, directors, or employees of the bank. Therefore, the statute would prevail over any instrument, authority, beneficiary consent, or court order purporting to authorize the transaction.

It is not only unlawful for officers of the bank to make the loan; the statute makes it a crime for the bank itself. In addition, it is a crime for a director, officer or employee to receive such a loan. All that is necessary is that the bank be trustee of the funds and that they be lent to a director, officer, or employee.

The fact that the transaction was performed by the bank at the direction of individuals does not make the bank any less a trustee in the eyes of the statute. (*Comptroller's Handbook for National Trust Examiners*, 5 Fed. Banking L. Rep. (CCH) ¶59,246, subsection 9.3650 (Jan. 1985).)

Finally, Trust Examining Circular 13, which I have attached, issued July 10, 1981, states that the act of making or receiving a loan of funds held in trust by a national bank is, in itself, a violation of the law regardless of the intent of the parties involved. This circular lists procedures to be followed in the preparation of criminal referrals to the United States Attorney's Office for violation of section 92a(h).

As you can see, this Office continues to view such violations very seriously. Section 92a(h) is a *malum prohibitum* statute which provides for strict liability, regardless of the intent of the parties. The facts of the case you have described — loan of bank trust funds to a bank officer at the direction of the settlor — emphasize the need for such a statute. In our view, Congress sought to eliminate potentially overreaching, self-interested practices by fiduciaries in order to protect trust beneficiaries. If I can be of further assistance, please do not hesitate to call.

Dean E. Miller
Deputy Comptroller for Trusts and Securities

* * *

403—December 9, 1987

T.V. Adams
Senior Vice President and
Deputy General Counsel
First Union Corporation
Charlotte, North Carolina 28288

Dear Mr. Adams

This is in response to your letter dated March 30, 1987, notifying us of the intent of First Union National Bank of North Carolina (the Bank) to establish a de novo operating subsidiary, First Union Securities Corporation (the Subsidiary). The Subsidiary will provide brokerage services and investment advice to retail and institutional customers. The proposed services are within the scope of activities which the Office has previously determined to be permissible for national banks and their operating subsidiaries. Accordingly, the Bank may proceed with its proposal.

The Bank's Proposal

Our understanding of the Bank's proposal is based upon

the Bank's notification letter, a legal memorandum provided by Bank counsel, and conversations between Bank counsel and Deborah Katz, an attorney in the Legal Advisory Services Division of this Office

The Subsidiary's brokerage services will include related securities credit activities (margin accounts) and other related activities such as custodian services and individual retirement accounts. It will also provide investment advice consisting of both general and specific or personalized advice with respect to the appropriateness of particular investments for a customer's individual investment requirements. The investment advice will include advice generated by the Company's own research department, research generated by an affiliated company (such as the Capital Management Group of First Union National Bank of North Carolina) or by unrelated third parties.

The Subsidiary will make recommendations to customers from a broad range of secondary market securities and collective investment securities products including mutual funds and UITs. In its capacity as investment advisor and broker, the Subsidiary proposes to advise a mutual fund and to simultaneously offer investment advice and purchase fund shares on the order and for the account of its customers. The Subsidiary will insure that all appropriate disclosures mandated by the federal securities laws are made in connection with these activities.

Where the Subsidiary offers advice regarding mutual fund shares and UIT interests, the Subsidiary will provide information to its customers indicating that, while particular funds and UITs may be recommended or suggested as investments, such funds and UITs are sponsored by third parties independent of the Subsidiary, the Bank, and affiliates thereof. The information will also state that such shares or interest are not endorsed or guaranteed by, and do not constitute obligations of, the Subsidiary, the Bank, or its affiliates. It will further state that the mutual fund shares and UIT interests are not insured by the Federal Deposit Insurance Corporation.

The Subsidiary will not manage customer accounts on a discretionary basis and the customer will always make the final decision on the purchase or sale of securities. The Subsidiary will not engage in the underwriting of securities, will not deal in securities, and will not purchase securities for its own account except to the extent that national banks are permitted to do so under applicable law. The Subsidiary will register as a broker-dealer under the Securities Exchange Act of 1934 and as an investment adviser under the Investment Advisers Act of 1940.

The principal office of the Subsidiary will be located in Charlotte, North Carolina, in the main office complex of First Union National Bank of North Carolina. Additional

offices of the Subsidiary may be opened throughout the United States.

Discussion

In our opinion, all of the Subsidiary's proposed activities are permissible for national banks and their operating subsidiaries under the National Bank Act and the Glass-Steagall Act. Indeed, the Bank's proposal is within the scope of activities which have been previously considered and found permissible by this Office, other regulatory agencies, or the courts.

It is well established that national banks and their subsidiaries may perform brokerage services for their customers under Section 16 of the Glass-Steagall Act. See, e.g., *Securities Industry Association v. Comptroller of the Currency*, 577 F. Supp. 252 (D.D.C. 1983), *aff'd per curiam*, 758 F.2d 739 (D.C. Cir. 1985), *cert. denied*, 106 S.Ct. 790 (1986) (brokerage issue), *rev'd*, 93 L.Ed.2d 757 (1987) (branching issue) (Security Pacific). See also *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 468 U.S. 207 (1984) (Schwab) (bank holding companies).

Similarly, the Office has also determined that the provision of investment advice is permissible for national banks. See, e.g., *Decision of the Comptroller of the Currency Concerning an Application by American National Bank of Austin, Texas, to Establish an Operating Subsidiary to Provide Investment Advice* (September 2, 1983), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 99,732, *suit filed*, *Securities Industry Association v. Conover*, No. 83-3581 (D.D.C. November 30, 1983) (*American National Decision*) (extensive analysis and authorities); OCC Letter No. 367 (August 19, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,537. Moreover, the provision of investment advice also has been found permissible under the Glass-Steagall Act in the context of activities by bank holding company affiliates of member banks. See *Board of Governors of the Federal Reserve System v. Investment Company Institute*, 450 U.S. 46 (1981).

The combination of investment advisory, planning, or information services and brokerage services in related subsidiaries, or in the same subsidiary, has also been previously approved by the Office. See, e.g., *American National Decision*, *supra* (related subsidiaries, full range of investment advisory services, including specific advice, institutional or retail customers); OCC Letter No. 360 (April 16, 1986), *reprinted in* Fed. Banking L. Rep. ¶ 85,530 (same subsidiary, general research information and advice institutional customers); OCC Letter No. 370 (April 16, 1986) *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,540 (same subsidiary, includes specific advice, retail customers). The staff has also taken a no-objection position with regard to the provision of a financial planning

service and brokerage services within the bank. See OCC No-action Letter No. 85-1 (July 30, 1985), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 84,001. The Federal Reserve Board similarly has approved the combination of investment advisory services and securities brokerage in a single company for bank holding company affiliates of member banks. See National Westminster Approval Order, 72 Fed. Res. Bull. 584 (June 13, 1986). This order was recently upheld by the D.C. Circuit Court which ruled that the combined provision of securities brokerage services and investment advice by a member bank's affiliate does not transform these separately permissible activities into a "public sale" of securities prohibited by Section 20 of the Glass-Steagall Act. See *Securities Industry Association v. Board of Governors of the Federal Reserve System*, No. 86-1412, slip op. at 10 (D.C. Cir. July 7, 1987).

Moreover, another recent case has considered and approved a bank's provision of both advisory services and agency transaction services under Section 16 of the Glass-Steagall Act, although in a different context. See *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 807 F.2d 1052 (D.C. Cir. 1986) (*Bankers Trust*). In that case, the bank both advised issuers of commercial paper regarding structure and terms and then assisted the issuers, as agent, in privately placing the commercial paper. The court expressly rejected the argument that the combination with advice transformed the bank's agency transactional activity (*i.e.*, selling the commercial paper as agent for the issuer) into an activity prohibited by the Glass-Steagall Act; instead the court held such activity was squarely permitted under section 16 of the Act. *Bankers Trust*, 807 F.2d at 1061. We believe this analysis also supports the permissibility of the combined provision of investment advice and brokerage service.

As noted above, the Subsidiary will offer investment advice to a mutual fund and simultaneously provide investment advice and brokerage services to its customers. The Subsidiary may recommend, purchase or sell shares of the mutual fund for which it will act as investment advisor. In our opinion, the contemporaneous provision of these services is a permissible activity under the national banking laws, including the Glass-Steagall Act. The disclosures required by the federal securities laws and regulations, which govern such transactions, will provide customers with sufficient information to alleviate any concerns relating to conflicts of interest. See *Bankers Trust*, 807 F.2d at 1067; see generally *Securities Industry Association v. Board of Governors of the Federal Reserve System*, No. 86-1412, slip op. at 19 (hazards not likely to develop given realities of brokerage industry and commitments made by the bank).

Although there is obviously no "affiliation" within the meaning of Section 20 or 32 of the Glass-Steagall Act

between the Subsidiary and the mutual fund which it will advise, see 12 U.S.C. § 221a, the Subsidiary would be considered an affiliate of the investment company it advises for the purposes of Section 23A of the Federal Reserve Act. See 12 U.S.C. § 371c(b)(1)(D). This statute defines a covered transaction to include "the acceptance of securities issued by the affiliate as collateral security for a loan or extension of credit to any person or company." 12 U.S.C. § 371c(b)(7)(D). Where the Subsidiary allows its customers to purchase on margin shares of the mutual fund for which it acts as investment advisor, such margin lending will be deemed a covered transaction. If the Subsidiary chooses to engage in margin lending with respect to the mutual fund shares described above, it will have to comply with the pertinent limitations and requirements of 12 U.S.C. § 371c.

You state that the principal office of the Subsidiary will be located in the main office complex of the Bank; however additional offices of the Subsidiary may be opened throughout the United States. In our opinion, the Subsidiary's proposed activities do not include the types of business for which a branch license is required under 12 U.S.C. § 36(f), and therefore the bank may offer them at locations other than its branches.

In a recent case, the Supreme Court affirmed the Office's decision that a national bank could offer discount brokerage at non-branch locations because discount brokerage did not involve the three types of core banking business enumerated in section 36(f) or an activity similar to the enumerated types. See *Security Pacific*, 93 L.Ed.2d at 772-75. The Office also has previously taken the position that the provision of investment advice is likewise not an activity requiring a branch license under section 36(f) because it too is not one of the three enumerated activities. See Letter from Michael Patriarca, Deputy Comptroller (March 28, 1985). The recent case in the related area of discount brokerage is supportive of that analysis. Thus, the Subsidiary's proposed activities may be offered at locations other than approved branches.

Where the Subsidiary is engaged in margin lending for customers, please note that the Bank and Subsidiary must take appropriate steps to ensure this activity is conducted in compliance with 12 U.S.C. § 36. See, e.g., 12 C.F.R. § 7.7380.

Finally, the provision of investment advice and brokerage services does not constitute a securities activity subject to the moratorium enacted on August 10, 1987. See Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 201, 100 Stat. 552. This statute specifically excludes from moratorium coverage activities in which an insured bank or its subsidiary "acts only as agent" as well as "those activities which had been lawfully engaged in prior to March 5, 1987." § 201(b)(2). Here, the Subsidiary will

provide investment advisory services and buy and sell securities solely on the order and for the account of customers, acting purely in an agency capacity. Furthermore, it will engage in activities which have been "legally authorized in writing prior to March 5, 1987." See § 201(b)(2)(B). Therefore, we believe that the moratorium does not apply to the Bank's proposal.

Conclusion

As set forth above, the Subsidiary's proposed activities are within the scope of activities previously determined to be permissible for national banks and their operating subsidiaries. Thus, in light of the above precedents and based upon our review of your description of the Subsidiary's activities and your legal analysis, we believe the Subsidiary's proposed activities are permissible. Accordingly, the Bank may proceed with its proposal under 12 C.F.R. § 5.34.

The Bank and the Subsidiary will be expected to comply with the laws and regulations applicable to the manner in which these activities are conducted and to comply with any future developments in Office policy and guidance to national banks in this area. The Bank and the Subsidiary will also be expected to conduct these activities in a prudent manner, consistent with safe and sound banking practice and subject to this Office's supervisory authority.

Our opinion is based upon the facts represented in the Bank's notification. Different facts or circumstances may affect the position taken. In addition, our view is based on current law and may be subject to revision as future developments warrant. We further reserve the right to modify the view expressed herein or provide additional comments in the future.

J. Michael Shepherd
Senior Deputy Comptroller
for Corporate and Economic Programs

* * *

404—March 5, 1986

Re: Directors and Officers Indemnification

This is in response to your letter of December 5, 1985, in which you asked for this Office's advice concerning the indemnification by the *** (Bank) for the legal expenses of an officer or director resulting from a shareholder derivative suit.

Specifically, you state that the Bank's director and officer liability insurance coverage expired in October 1985, and that the Bank, to date, has not been able to obtain a

replacement costs. You also state that Article Tenth of the Bank's Articles of Association, which provides for the indemnification of officers and directors in specified circumstances, provides some degree of protection for legal expenses incurred by Bank officers and directors. However, two members of the Bank's board of directors have advised you that Article Tenth may not protect an officer or director in a shareholder derivative suit. You have asked for this Office's opinion on whether the Bank may indemnify officers and directors for legal expenses in a shareholder derivative suit.

Currently, the OCC has two standards in effect concerning the indemnification of directors and officers. Interpretive Rule 7.5217 (1985), found at 12 C.F.R. § 7.5217 (1985), states that a bank may provide in its articles of association for the indemnification of directors, officers and employees, and that such indemnification articles are presumed by the OCC to be within the corporate powers of a national bank if such articles substantially reflect the general standards of law of the state of the bank or bank holding company or the Model Business Corporation Act (MBCA). This standard, however, applies to those banks that have adopted or modified their indemnification articles after the effective date of the interpretive rule, September 4, 1984. For those banks that have indemnification articles in effect prior to September 4, 1984, and have not revised such articles since that date, the standard of the prior Interpretive Rule 7.5217 (1984) is applicable. A review of our records shows that the Bank has not revised its indemnification article, Article Tenth, since the effective date of Interpretive Rule 7.5217 (1985) and thus, the prior rule would be applicable. Interpretive Rule 7.5217 (1984) states:

(a) In order to secure and retain competent personnel, a national bank may amend its articles of association to provide for the indemnification of directors, officers, and other employees against legal and other expenses incurred in defending law suits brought against them by reason of the performance of their official duties.

(b) Payment of premiums for insurance covering such indemnification of officers, directors, and other employees is a permissible expense.

(c) It should be understood, however, that in order to preserve incentives for sound banking principles neither the bank's articles of association, bylaws, shareholder resolutions nor insurance shall provide for the indemnification of bank personnel who are adjudged guilty of, or liable for, willful misconduct, gross neglect of duty, or criminal acts.

Thus, Interpretive Rule 7.5217 (1984) allows a bank to indemnify a director or officer but only if such indemnifi-

cation is provided for in the bank's articles of association, and prohibits any indemnification if the director or officer is adjudged guilty of, or liable for willful misconduct, gross neglect of duty, or criminal acts.

In your case, Article Tenth appears consistent with the standard of Interpretive Rule 7.5217 (1984), and therefore, would not prevent, generally, the Bank from indemnifying at its discretion the directors and officers of the Bank for legal expenses incurred in a shareholder derivative or other suit. To prevent any confusion on the matter, the Bank may want to amend its Article Tenth to state specifically that the Bank may indemnify directors and officers in shareholder derivative suits. Of course, whether a director or officer would actually be indemnified for legal expenses would depend on the specific facts of the case.

I trust that this has been responsive to your inquiry.

H. Joe Selby
Senior Deputy Comptroller for
Bank Supervision

* * *

405—April 16, 1986

In your letter of March 5, 1986, you requested that this Office commend on the requirement in 12 U.S.C. § 62 which provides that the Bank's list of shareholders must be made available for inspection by any shareholder of the Bank. You suggest in your letter that this Office should consider adopting a change in the regulations which would delete the statutory requirement that a national bank must make its shareholders list available for inspection by any shareholder of such bank. Also, you specifically question what purpose can be served by retaining this provision in the law.

Title 12 U.S.C. § 62, a federal statute, provides:

§62 List of shareholders

The president and cashier of every national banking association shall cause to be kept at all times a full and correct list of the names and residences of all the shareholders in the association, and the number of shares held by each, in the office where its business is transacted. Such list shall be subject to the inspection of all the shareholders and creditors of the association, and the officers authorized to assess taxes under State authority, during business hours of each day in which business may be legally transacted. A copy of such list, verified by the oath of such president or cashier, shall be transmitted to the Comptroller of the Currency within ten days of any demand therefor made by him.

Although at common law the right of a shareholder to inspect the books and records of the corporation was limited by a proper purpose requirement, see *Guthrie v. Harkness*, 199 U.S. 148 (1905), the plain language of the 12 U.S.C. § 62 does not require the satisfaction of any condition precedent prior to inspection of a national bank's shareholders' list. As of yet, no federal court has addressed the issue of whether the federal statute implicitly incorporates the common law proper purpose test. However, almost all of the state courts to date which have interpreted 12 U.S.C. § 62 have found that a shareholder's statutory right of inspection of a national bank's list of shareholders is absolute and unqualified. See, e.g., *Most v. First National Bank of San Diego*, 246 Ca. App. 2d 425, 54 Cal. Rptr. 669, 673 (Cal. Ct. App. 1966) (and cases cited therein); 9 C.J.S. *Banks and Banking* § 584 (1938 & Supp. 1985). But see *Jolly v. Marion National Bank*, 267 S.C. 681, 231 S.E. 2d 206 (S.C. 1976) (the Supreme Court of South Carolina held that 12 U.S.C. § 62 does not give shareholders of a national bank the absolute right to a writ of mandamus to inspect the shareholders' list and this court found that a national bank shareholder's right of inspection under 12 U.S.C. § 62 is implicitly limited by a legitimate purpose requirement). In view of the foregoing, this Office offers no comment at this time on how this particular point of law would be decided by a Michigan court.

With regard to your point questioning the purpose of retaining 12 U.S.C. § 62, it is helpful to consider the legislative history of this law. This provision was part of the original National Bank Act enacted on June 3, 1964, c. 106, § 40, 13 Stat. 111. The primary purpose of this statute, as enacted, was to identify those shareholders upon whom double liability would be imposed in the case of insolvency of a national bank. See, e.g., *McDonald v. Dewey*, 202 U.S. 510 (1906). However, as you are probably aware, this additional liability on shareholders of national banks was severely limited in 1933 when 12 U.S.C. § 64a was enacted into law, Pub. L. No. 73-66, c. 89, § 22, 48 Stat. 189, and the double liability statutes were altogether repealed in Pub. L. No. 86-230, § 7, 73 Stat. 457 (1959).

Congress last amended 12 U.S.C. § 62 in 1953. However, the only provision of the original statute which was changed was that a national bank's shareholders' list is no longer required to be filed annually with the Comptroller of the Currency but rather the list can now be obtained by the Comptroller at any time on ten days' notice. Pub. L. No. 83-28, c. 59, § 1, 67 Stat. 27 (1953). While noting that the primary purpose for which the list was originally required had disappeared and, thus, obviated, the usefulness of an annual submission of the list to the Comptroller, the legislative history clearly reveals that Congress intended no change in the right of shareholders to inspect the list.

The bill in no way changes the present requirement of law that a full and correct list of all shareholders, their addresses, and the number of shares held by each be kept in the office of the bank and open to inspection of all shareholders, bank creditors, and officers authorized to assess taxes under State law (H. R. Rep. No. 259, 83d Cong., 1st Sess., reprinted in 1953 U.S. Code Cong. & Ad. News 1641, 1642.)

Apparently, Congress has determined that this list should be open for inspection by all shareholders of a national bank for important reasons which are independent of the double liability concerns which motivated the enactment of the statute. As a matter of general corporation law, the importance of a shareholders' right of inspection of the list is well recognized and one federal court has described it thusly: "[t]he right to examine the stockholders [sic] list is a basic privilege of every stockholder of a corporation and should be given the widest recognition as fundamental to corporate democracy." *Durnin v. Allentown Federal Savings and Loan Association*, 218 F. Supp. 716, 718 (E.D. Pa. 1963). As limited to this issue, these same concerns would be as applicable to a national bank as to any other corporation. Cf. *Guthrie v. Harkness*, 199 U.S. at 157.

It is hoped that this information is responsive to your request.

Charles M. Horn
Assistant Director
Securities & Corporate
Practices Division

* * *

406—August 4, 1987

This responds to your request on behalf of *** for the views of this Office regarding a proposal to provide brokerage services on the premises of national banks (Subscribers).¹ Our views as set forth below are based on the facts and representations set forth in your letters of August 28, 1985 and March 3, August 25 and September 22, 1986 and accompanying documentation, as well as related conversations with the staff of the Securities and Corporate Practices Division.

As you are aware, on June 4, 1985, this Office issued a no-objection opinion concerning a similar proposal by

¹*** is a registered broker-dealer and a licensed member of the National Association of Securities Dealers (NASD). All *** representatives assigned to national banks pursuant to this proposal will also be licensed by the NASD. *** will not purchase or sell securities for its own account or engage in securities underwriting or market-making. A more complete description of the *** proposal is contained in this Office's letter of February 10, 1986.

the ISFA Corporation to make the INVEST securities brokerage and investment advisory services program (the INVEST Program) available on the premises of national banks. We have reviewed the proposed activities of *** and have concluded that in all material respects they are identical to the activities of the INVEST Program which were discussed in this 1985 letter.

Under the INVEST Program, as described to this Office by ISFA, a participating national bank enters into a contract with ISFA, which provides for the establishment of INVEST Service Centers (Centers) on bank premises. The Centers provide brokerage services and standardized investment advice to bank customers through individuals who are dual employees of ISFA and the subscribing bank. ISFA does not purchase or sell securities for its own account or engage in securities underwriting activities. ISFA exercises exclusive control and supervision over the dual employees' conduct of the INVEST business, and determines precisely the investment advice to be provided. As compensation for the services of the dual employees (whose salaries are paid by the bank) and for the rental of the space occupied by INVEST, ISFA makes monthly payments to the bank, based upon a fixed percentage (generally 50%) of the revenue attributable to transactions effected at the INVEST Center. ISFA deducts from the monthly payments a portion of the losses incurred as a result of the failure of any customer to meet its obligations to ISFA.

The activities of the INVEST Centers are limited to those which may be performed by national banks under the national banking laws, and the Centers do not conduct transactions for the fiduciary accounts of subscribing banks or handle discretionary accounts. The INVEST Program is structured to maintain a strict separation between ISFA's business and that of the subscribing bank. Various provisions have been included in the INVEST Program to assure this separation, including the maintenance of separate records, the segregation of the INVEST Center in a clearly identified area of the bank, and written notice to all INVEST customers that the services of the latter are provided by INVEST alone. Further, under no circumstances does bank liability under the INVEST Program (limited to customer failures to meet obligations) exceed the amount of revenue-sharing payments payable to the bank from program-related securities transactions. For a more complete description of the INVEST Program, see Letter from Richard V. Fitzgerald, Chief Counsel, to Thomas A. Russo (June 4, 1985) (the INVEST Letter) and supporting submissions.

It is well established that national banks may lease their excess office space to others pursuant to 12 U.S.C. §§ 29 and 24 (Seventh). See *Wirtz v. First National Bank & Trust Co.*, 365 F.2d 641, 644 (10th Cir. 1966); *Wingert v. First National Bank*, 175 F. 739, 741 (4th Cir. 1909), appeal

dismissed, 223 U.S. 670 (1912), *Brown v. Schleier*, 118 F. 981, 984 (8th Cir. 1902), *aff'd*, 194 U.S. 18 (1904). Incidental to a national bank's power to lease its office space is the authority to establish appropriate lease terms by bargaining for whatever terms are usual and customary in the leasing of commercial office space. See Interpretive Letter No. 294 from Brian Smith, Chief Counsel (Dec. 2, 1983), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,438. As a result, the Office concluded in Interpretive Letter No. 294 that a bank may lease excess space in its lobby to an insurance agent, and receive rent in the form of a percentage of the insurance agent's volume of sales or gross income from the rented lobby space. See *id.* Renting lobby space under such a "percentage lease" is conditioned on the observance of the precautions enumerated by Interpretive Letter No. 294, such as the requirement that the lessee's business be appropriately and separately identified, to ensure that all aspects of the leasing relationship are in accord with federal banking laws and safe and sound banking practices.

Since the lessee addressed by Interpretive Letter No. 294 was not a bank employee and did not propose to employ bank employees to sell the lessee's products and services, the Interpretive Letter did not address the circumstances under which a national bank could share its employees with a party renting lobby space under a percentage lease. With the subsequent issuance of the INVEST Letter, the Office indicated that the combination of percentage leasing with employee sharing does not give cause for objection where the employees of the bank and the lessee on bank premises are only performing activities that are permissible for national banks.

In considering the authority of national banks to participate through the use of shared employees in brokerage services programs such as the INVEST Program and the instant one proposed by *** we note that the authority of national banks to provide securities brokerage services is conclusively established. See *Securities Industry Association v. Comptroller of the Currency*, 758 F.2d 739 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 790 (1986) (brokerage issue), *rev'd* 107 S. Ct. 750 (1987) (branching issue). Further, in accordance with the incidental powers clause of 12 U.S.C. § 24 (Seventh), national banks may exercise all powers incidental to the business of banking. Programs such as those offered by ISFA and *** when conducted in compliance with the national banking laws, enable a national bank to make authorized brokerage services available on its premises through use of its employees, particularly under circumstances where it may not be economical, practical or efficient for the bank to provide the services directly to its customers. When economic, geographic or other reasons make advisable the providing of such services but the demand for them is uncertain, or the subscribing bank does not wish for other reasons to commit its own resources to the estab-

lishment of a brokerage department or an operating subsidiary, the use of bank employees in this type of program may offer the banks a low-cost, low-risk alternative way of providing such brokerage services to its own customers. Accordingly, the Office is of the view that national banks' use of dual employees in such programs, as described herein and in the INVEST letter, is incidental to the provision of an authorized banking service — brokerage — and is therefore authorized as part of the business of banking under 12 U.S.C. § 24 (Seventh). See *Wyman v. Wallace*, 201 U.S. 230, 243 (1906) (authorizing activity that relates to demands of bank's business and is not expressly prohibited by national banking act); *Miller v. King*, 223 U.S. 505, 511 (1912) (authorizing activity that is not so disconnected with banking business as to violate 12 U.S.C. § 24 (Seventh)); *Clement National Bank v. Vermont*, 231 U.S. 120, 140 (1913) (authorizing activity that promotes the convenience of the bank's business). See generally *M&M Leasing Corp. v. Seattle First National Bank*, 563 F.2d 1577 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978); *American Insurance Association v. Clarke*, 656 F. Supp. 404 (D.D.C. 1987), *appeal pending*, No. _____ (D.C. Cir. 1987).

We also note that the use of dual employees in these brokerage programs will not cause participating banks to violate Section 32 of the Glass-Steagall Act, 12 U.S.C. § 78, which prohibits, *inter alia*, employees of an organization "primarily engaged in the issue, flotation, underwriting, public sale, or distribution . . . of stocks, bonds, or similar securities" from serving simultaneously as employees of member banks of the Federal Reserve System (*i.e.*, national banks). The Supreme Court has approved the Federal Reserve Board's longstanding position that the securities activities described in Section 32 do not include brokerage transactions conducted as agent for customers. See *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 468 U.S. 207, 218-219 (1984) (interpretation of identical language contained in Sections 20 and 32 of Glass-Steagall). As indicated, the brokerage services that are provided through the INVEST and the *** are limited to activities which are authorized for national banks, and are provided on an agency basis only. Since it is established that the prohibitory language of Section 32 does not encompass these securities activities, it is clear that Section 32 does not preclude a national bank's use of the dual employees as part of the INVEST Program or the brokerage program described herein.

The *** Program, as described in your several letters and supporting documentation, resembles the INVEST Program in many respects, except that the *** program is limited to securities brokerage and, unlike INVEST, does not include investment advisory services. In addition, there are several other differences between the two programs, which we have concluded are not material and

do not affect the authority of a national bank to participate in the program. The principal of these differences are the following:

1) Tripartite structure

*** proposes to enter into an agreement with another broker-dealer (B/D) for the purpose of having *** market the program to banks and recruit and train the employee representatives. B/D which will act in a consulting capacity to ***, will provide administrative support and will perform such activities as producing the marketing and advertising materials for the program, providing computer equipment, and training the employee representatives under ***'s supervision. For these services, B/DD will receive a portion of the commissions generated from the brokerage program.

Essentially *** will be contracting out to B/D certain of the responsibilities for managing the program. To the extent that *** may lawfully enter into an agreement with national banks to provide brokerage services on bank premises, we see no objection to B/D performing whatever activities are permissible for ***. Our position, however, is based upon your assurance that *** will at all times retain ultimate supervisory responsibility over the employee representatives and the conduct of the program.

2) Compensation/commission structure

The contractual agreement to be entered into by ***, and subscribing banks (the Agreement) provides that the bank employee representatives participating in the program will be paid a fixed salary by the bank. In addition to that salary, banks may choose to pay these employees some sort of incentive bonus. The Agreement further provides that Subscribers will receive from *** monthly payments consisting of reimbursement for the full amount of employee salaries (including bonuses), and a share of remaining program revenues after employee salaries are deducted. (That share will be 50% during the first year and 60% in subsequent years.) B/D and *** will also receive certain specified percentages of the monthly brokerage commissions. In the event that revenues in any given month should fall below the amount needed to reimburse the bank for the employees' salaries, B/D contracts to pay the bank the amount of shortfall, thus insulating the bank from any loss.²

²This feature of the *** program differs from the INVEST Program. In the latter, although salaries were paid by the subscribing bank, the Subscriber's share of profits from the program was computed without reference to employee compensation and without dollar-for-dollar reimbursement.

The Office has considered whether the proposed commission structure, which include the use of transaction-based compensation for both the Subscriber and its employees, results in the creation of an impermissible partnership relationship between *** and B/D on the one hand and the Subscriber on the other.

As a rule, a national bank lacks the power to enter into a general partnership or other relationship which results in the bank's having unlimited liability for the debts of others. *Merchants National Bank v. Wehrmann*, 202 U.S. 295 (1906). In determining whether a partnership exists, the right to a portion of the profits of a business (i.e., proceeds after deduction of expenses) normally creates the presumption of a partnership — a presumption which does not arise when only gross returns are shared.³ An agreement to share both expenses and income, as is the case here, where Subscribers are responsible for such costs of the program as telephone costs and certain training-related expenses, might be considered profit-sharing and thereby raise the presumption. An exception to this rule arises, however, if the profits are received either as compensation for services or as rent, in the form of a percentage lease.⁴ See UPA § 7(4)(b).

Both of these exceptions would seem to apply to the *** proposal. The monthly payments which the bank will receive from the total program revenues represent its share of the profits from the securities brokerage program. As stated above, part of these payments will be dollar-for-dollar reimbursement for the salaries of the employee representatives, including any bonuses paid by the bank. These amounts fall within the exception to the general presumption of a partnership created by profit-sharing where profits are received as compensation for services. The balance of the monthly payments to Subscribers, which represent compensation for ***'s use of bank space, fall within the exception to the presumption of partnership where such payments are received as rent.

Our analysis is not affected by the specific percentage shares assigned under the Agreement. While the 50%-60% share Subscribers will receive under the *** program is higher than the percentage rent paid under percentage leases in most industries,⁵ the principle that a

share of profits may be received as rent without raising a presumption of partnership does not require that the percentage be set at any particular level. On the contrary, the exact terms are a matter for negotiation between the parties.

Finally, while we believe that participating banks would not be considered general partners of *** under the UPA and general principles of partnership law, the resolution of this questions is ultimately a matter of state law, and may vary from state to state. We also note that it is possible that the bank's relationship with *** might be construed as a limited partnership in certain states, with the bank having the status of a limited partner. Since *Wehrmann* "is based wholly and exclusively upon the unlimited liability exposure of a general partner," the Office has permitted national banks to become limited partners in banking-related ventures. Interpretive Letter No. 289 from Michael Patriarca, Deputy Comptroller (May 15, 1984), reprinted in Fed. Banking L. Rep. (CCH) ¶ 85,453. See also Letter from Charles F. Byrd, Assistant Director, Legal Advisory Services Division (July 1, 1981); Letter from Eugene Marsico, Jr., Attorney (July 15, 1985). Thus, even if a national bank were deemed to be a limited partner in the *** Program, the bank would be acting within its authority since the *** Program is limited to the permissible bank activity of securities brokerage. In any event, participating national banks are advised to consult applicable state law on the questions of partnership criteria, and are further reminded of their responsibility for ensuring that they do not incur general partnership liability as a result of their participation in the *** Program.

3) Indemnification

The Agreement provides that the Subscriber will indemnify B/D and *** for any "illegal" acts of its own employees (i.e., bank employees not participating in the program). The bank's liability in such instances will be limited "to the amount of revenues earned" in the program, including "future revenues," and under no circumstances will the bank be liable beyond brokerage services revenues. In the event of such an eventuality occurring, *** may deduct from payments owed to the bank from its share of program revenues, (extending to the term of the Agreement) but no other bank assets will be at risk.

The Office will not object to this provision of the Agreement, provided that the Agreement (or supporting documentation) is amended to include a section which specifically enumerates permitted and prohibited activities for such non-participating bank employees, similar to the comparable section in the "Compliance Manual for INVEST Participants," which was incorporated into ISFA's contract with all national banks participating in the INVEST Program. The documentation accompanying

³See Uniform Partnership Act ("UPA") §§ 7(3) and 7 (4) (adopted in every state except Louisiana) J. Crane and A. Bromberg, *Law of Partnership* § 14, pp. 66-69 (1968).

⁴This Office has generally permitted banks to bargain for "whatever terms are usual and customary in the leasing of commercial office space" provided that the percentage required is not unusually high and the bank does not exercise control over the lessee's business. See, e.g., Interpretive Letter No. 294 *supra*.

⁵See *Fredman on Leases* § 63 (2d ed. 1983).

your letter of January 30, 1987 sets forth just such a list of permitted and prohibited activities.

On the basis of the facts and circumstances set forth in your letters of August 28, 1985 and March 3, August 25 and September 22, 1986, and supporting documentation and with the understanding that the Agreement and other documents to be used by *** (including the Representative Agreement to be signed by employee representatives) will conform to those submitted to us as modified by the representations in your letter of August 25, 1986, (all of which letters and documents are incorporated herein by reference), and with the qualifications expressed herein, we will raise no objection to the participation of national banks in the *** Program. We wish to emphasize that all conditions stated in the INVEST Letter, particularly with respect to the limitation of program activities to those permissible for national banks, and the restriction of participating banks' liabilities to the revenues due the banks under the agreement, as well as all conditions stated in this letter, are applicable to the *** Program.

Because this position is based upon the representations made in your several letters and supporting documentation, as noted above, it should be noted that any different facts or conditions might require a different conclusion. In addition, please note that our view is based on current law and regulation and may be subject to revision as future judicial, regulatory or legislative developments warrant. We will, of course, continue to monitor national bank participation in the program and we reserve the right to modify the views expressed herein or provide additional comments in the future.

Charles M. Horn
Director
Securities & Corporate Practices Division

* * *

407—August 4, 1987

We are in receipt of your request, on behalf of *** (FBS), for a staff no-objection response to national bank participation in the program of securities brokerage and investment advisory services to be offered by FBS (the FBS Program).¹

¹FBS is the wholly owned subsidiary of two individuals having no affiliation with any bank or savings and loan association or any broker-dealer or investment advisor other than FBS. FBS is registered with the Securities and Exchange Commission as a broker, dealer and investment advisor and is a member of the National Association of Securities Dealers and the Securities Investor Protection Corporation. FBS will not purchase or sell securities for its own account or engage in securities underwriting or market-making

This response is based on your letters of April 16 June 20, July 3, and July 22, 1986, and February 5, and February 27, 1987, and accompanying documentation, as well as related conversations with the staff of this Division. As you are aware, on June 4, 1985, this Office issued a no-objection opinion with regard to a similar proposal of the ISFA Corporation to make the INVEST securities brokerage and investment advisory services program (the INVEST Program) available on the premises of national banks. We have reviewed the proposed activities of the FBS Program and have concluded that in all material respects they are identical to the activities of the INVEST Program which were discussed in this 1985 letter.

Under the INVEST Program, as described to this Office by ISFA, a participating national bank enters into a contract with ISFA, which provides for the establishment of INVEST Service Centers (Centers) on bank premises. The Centers provide brokerage services and standardized investment advice to customers through individuals who are dual employees of ISFA and the subscribing bank. ISFA does not purchase or sell securities for its own account or engage in securities underwriting activities. ISFA exercises exclusive control over the dual employees' conduct of the INVEST business, and determines precisely the investment advice to be provided. As compensation for the services of the dual employees (whose salaries are paid by the bank) and for the rental of the space occupied by INVEST, ISFA makes monthly payments to the bank, based upon a fixed percentage (generally 50%) of the revenue attributable to transactions effected at the INVEST Center. ISFA deducts from the monthly payments a portion of the losses incurred as a result of the failure of any customer to meet its obligations to ISFA.

The activities of the INVEST Centers are limited to those which may be performed by national banks under the national banking laws, and the Centers do not conduct transactions for the fiduciary accounts of subscribing banks or handle discretionary accounts. The INVEST Program is structured to maintain a strict separation between ISFA's business and that of the subscribing bank. Various provisions have been included in the INVEST Program to assure this separation, including the maintenance of separate records, the segregation of the INVEST Center in a clearly identified area of the bank, and written notice to all INVEST customers that the services of the latter are provided by INVEST alone. Further, under no circumstances does bank liability under the INVEST Program (limited to customer failures to meet obligations) exceed the amount of revenue-sharing payments payable to the bank from program-related securities transactions. For a more complete description of the INVEST Program, see Letter from Richard V. Fitzgerald, Chief Counsel, to Thomas A. Russo (June 4, 1985) (the INVEST Letter) and supporting submissions.

It is well established that national banks may lease their excess office space to others pursuant to 12 U.S.C. §§ 29 and 24 (Seventh). See *Wirtz v. First National Bank & Trust Co.*, 365 F.2d 641, 644 (10th Cir. 1966); *Wingert v. First National Bank*, 175 F.739, 741 (4th Cir. 1909), *appeal dismissed*, 223 U.S. 670 (1912); *Brown v. Schleier*, 118 F.981, 984 (8th Cir. 1902) *aff'd*, 194 U.S. 18 (1904). Incidental to a national bank's power to lease its office space is the authority to establish appropriate lease terms by bargaining for whatever terms are usual and customary in the leasing of commercial office space. See Interpretive Letter No. 294 from Brian Smith, Chief Counsel (Dec. 2, 1983), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,438. As a result, the Office concluded in Interpretive Letter No. 294 that a bank may lease excess space in its lobby to an insurance agent, and receive rent in the form of a percentage of the insurance agent's volume of sales or gross income from the rented lobby space. See *id.* Renting lobby space under such a "percentage lease" is conditioned on the observance of the precautions enumerated by Interpretive Letter No. 294, such as the requirement that the lessee's business be appropriately and separately identified, to ensure that all aspects of the leasing relationship are in accord with federal banking laws and safe and sound banking practices.

Since the lessee addressed by Interpretive Letter No. 294 was not a bank employee and did not propose to employ bank employees to sell the lessee's products and services, the Interpretive Letter did not address the circumstances under which a national bank could share its employees with a party renting lobby space under a percentage lease. With the subsequent issuance of the INVEST Letter, the Office indicated that the combination of percentage leasing with employee sharing does not give cause for objection where the employees of the bank and the lessee on bank premises are only performing activities that are permissible for national banks.

In considering the authority of national banks to participate through the use of shared employees in brokerage and investment advisory services programs such as the INVEST Program and the instant one proposed by FBS, we note that the authority of national banks to provide securities brokerage services is conclusively established. See *Securities Industry Association v. Comptroller of the Currency*, 758 F.2d 739 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 790 (1986) (brokerage issue), *rev'd*, 107 S. Ct. 750 (1987) (branching issue). Further, in accordance with the incidental powers clause of 12 U.S.C. § 24 (Seventh), national banks may exercise all powers incidental to the business of banking. National banks have traditionally provided investment advisory services as an incident to the business of banking. See Interpretive Letter No. 370 from Judith A. Walter, Senior Deputy Comptroller for National Operations (April 16, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,540. Programs such as those

offered by ISFA and FBS, when conducted in compliance with the national banking laws, enable a national bank to make authorized banking services available on its premises through use of its employees, particularly under circumstances where it may not be economical, practical or efficient for the bank to provide the services directly to its customers. When economics, geographic or other reasons make advisable the providing of such services but the demand for them is uncertain, or the subscribing bank does not wish for other reasons to commit its own resources to the establishment of a brokerage department or an operating subsidiary, the use of bank employees in this type of program may offer the bank a low-cost, low-risk alternative way of providing such services to its own customers. Accordingly, the Office is of the view that national banks' use of dual employees in such programs, as described herein and in the INVEST Letter, is incidental to the provision of authorized banking services, *i.e.*, brokerage and investment advice, and is therefore authorized as part of the business of banking under 12 U.S.C. § 24 (Seventh). See *Wyman v. Wallace*, 201 U.S. 230, 243 (1906) (authorizing activity that relates to demands of bank's business and is not expressly prohibited by national banking act); *Miller v. King*, 223 U.S. 505, 511 (1912) (authorizing activity that is not so disconnected with banking business as to violate 12 U.S.C. § 24 (Seventh)); *Clement National Bank v. Vermont*, 231 U.S. 120, 140 (1913) (authorizing activity that promotes the convenience of the bank's business). See generally *M&M Leasing Corp. v. Seattle First National Bank*, 563 F.2d 1577 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978); *American Insurance Association v. Clarke*, 656 F. Supp. 404 (D.D.C. 1987), *appeal pending*, No. _____ (D.C. Cir. 1987).

We also note that the use of dual employees in these brokerage programs will not cause participating banks to violate Section 32 of the Glass-Steagall Act, 12 U.S.C. § 78, which prohibits, *inter alia*, employees of an organization "primarily engaged in the issue, flotation, underwriting, public sale, or distribution . . . of stocks, bonds, or similar securities" from serving simultaneously as employees of member banks of the Federal Reserve System (*i.e.*, national banks). The Supreme Court has approved the Federal Reserve Board's longstanding position that the securities activities described in Section 32 do not include brokerage transactions conducted as agent for customers. See *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 468 U.S. 207, 218-219 (1984) (interpretation of identical language contained in Sections 20 and 32 of Glass-Steagall). Further, as recently confirmed by the Court of Appeals for the District of Columbia Circuit, the combined provision of investment advisory and permissible brokerage services by an affiliate of a member bank does not result in a prohibited securities activity within the meaning of the Glass-Steagall Act. See *Securities Industry*

Association v. Board of Governors of the Federal Reserve System, No. 86-1412 (D.C. Cir. July 7, 1987). As indicated, the brokerage and investment advisory services that are provided through the INVEST and the FBS Programs are limited to activities which are authorized for national banks, and brokerage services are provided on an agency basis only. Since it is established that the prohibitory language of Section 32 does not encompass these securities activities, it is clear that Section 32 does not preclude a national bank's use of the dual employees as part of the INVEST Program or the brokerage program described herein.

The FBS Program, as outlined in your several letters and supporting submissions, resembles the INVEST Program in numerous material respects. There are also several points of difference between the two, which we have concluded are not material and do not affect the authority of a national bank to participate in the program. The principal of these are the following:

(1) Use of Dual Employees

The FBS Brokerage Services Agreement (Agreement) provides that the dual employees will spend 100% of their time working for FBS, unless FBS consents to their performing services for the bank. You have represented that because the demand for FBS services at a particular location is uncertain, FBS wishes to have access to the full time services of the dual employees, while preserving the option of actually sharing their services with the bank. This provision allows for flexibility in meeting the staffing needs of particular FBS Centers, and therefore it may facilitate a bank's ability to ensure that its customers can receive brokerage services at the bank. We view this staffing flexibility as contributing to the overall efficiency of the bank's provision of brokerage services through the FBS Program on its premises and, accordingly, we raise no objection to this provision.

(2) Compensation Structure

The monthly payments to the banks from FBS will consist of 60% of the commissions received, from which transaction costs have been deducted, plus a performance incentive bonus based upon the gross commissions earned by the Center located at the bank. The banks, in turn, will not be prohibited from compensating the dual employees for their services to FBS based on the amount of commissions earned or volume of transactions conducted.

The Office has considered the proposed compensation arrangements, and the use of bonuses or transaction-based compensation for either the bank or its employees, in this context, could result in the creation of an impermissible partnership relationship between FBS and the bank.

As a rule, a national bank lacks the power to enter into

a general partnership which results in the bank's having unlimited liability for the debts of its partners. *Merchants National Bank v. Wehrmann*, 202 U.S. 295 (1906). In determining whether a partnership exists, the right to a portion of the profits of a business (i.e., proceeds after deduction of expenses) normally creates the presumption of a partnership — a presumption which does not arise when only gross returns are shared.² An agreement to share both expenses and income, as is the case here, where the banks are responsible for such costs of the program as the news/quote service, training and recruitment, and transaction costs, might be considered profit-sharing and thereby raise the partnership presumption. An exception to this rule arises, however, if the profits are received as compensation for services or as rent, in the form of a percentage lease.³ See UPA § 7(4)(b).

Both of these exceptions would seem to apply to the FBS proposal. We believe that the banks' payment of transaction or commission-based compensation to the dual employees, if deemed a profit sharing arrangement with FBS, would fall within the exception to the general presumption created by profit sharing where profits are received as compensation for services. Similarly, the monthly payments to the banks, which represent compensation for FBS' use of bank space and the employees' services, would appear to fall squarely within the exceptions to the presumption of partnership where profits are received as compensation for services or rent. Our analysis is not affected by the specific percentage shares assigned under the Agreement. While the 60% share the banks will receive under the FBS program is higher than the percentage rent paid under percentage leases in most industries,⁴ the principle that a share of profits may be received as rent without raising a presumption of partnership does not require that the percentage be set at any particular level. On the contrary, the exact terms are a matter for negotiation between the parties.

Further, in our view, the bank's receipt of the bonus based on gross monthly commissions to FBS represents additional compensation for the bank's provision of services (through its employees) to FBS, and therefore should also be considered within the exception for profits received as compensation for services. We do note that while a performance incentive bonus is not a customary or logical feature of a percentage lease, it is a standard compensation practice in the securities brokerage industry. Therefore, while the staff will not object to the bonus ele-

²See Uniform Partnership Act ("UPA") §§ 7(3) and 7(4) (adopted in every state except Louisiana); J. Crane and A. Bromberg, *Law of Partnership* § 14, pp. 66-69 (1968).

³This Office has generally permitted banks to bargain for "whatever terms are usual and customary in the leasing of commercial office space," provided that the percentage required is not unusually high and the bank does not exercise control over the lessee's business. See e.g., Interpretive Letter No. 294, *supra*.

⁴See *Friedman on Leases* § 6.3 (2d ed. 1983).

ment of the bank's compensation package, this position is based solely on the fact that the banks are responsible under the Agreement for supplying employee services to FBS.

Finally, while we believe that participating banks would not be considered general partners of FBS under the UPA and general principles of partnership law, the resolution of this question is ultimately a matter of state law, and may vary from state to state. We also note that it is possible that the bank's relationship with FBS might be construed as a limited partnership in certain states, with the bank having the status of a limited partner. Since *Wehrmann* "is based wholly and exclusively upon the unlimited liability exposure of a general partner," the Office has permitted national banks to become limited partners in banking-related ventures. Interpretive Letter No. 289 from Michael Patriarca, Deputy Comptroller (May 15, 1984), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,453. See also, Letter from Charles F. Byrd, Assistant Director, Legal Advisory Services Division (July 1, 1981); Letter from Eugene Marsico, Jr., Attorney (July 15, 1985). Thus, even if a national bank were deemed to be a limited partner in the FBS Program, the bank would be acting within its authority since the FBS Program is limited to permissible banking activities. In any event, participating national banks are advised to consult applicable state law on the questions of partnership criteria, and are further reminded of their responsibility for ensuring that they do not incur general partnership liability as a result of their participation in the FBS Program.

(3) Indemnification

The Agreement provides that participating banks will indemnify FBS for all liabilities arising from the bank's own employees' (i.e., bank employees not participating in the program) failure to comply with their obligations under the Agreement with FBS. The Agreement incorporates by reference the FBS "Policies and Procedures Manual," which includes a section that specifically enumerates permitted and prohibited activities for all non-participating bank employees. The bank's liability in all such instances will be limited to the amounts it is due from FBS under the Agreement and under no circumstances will the bank be liable to FBS beyond the bank's share of brokerage service revenues. In the event of such liability occurring, FBS may deduct from revenue sharing payments owed to the bank (extending to the term of the Agreement) but no other bank assets will be at risk. This Office will not object to this provision of the Agreement, which creates only a limited liability for banks under clearly defined circumstances.

(4) Bank as FBS Customer

The FBS Program contemplates that the FBS securities services will be available to the participating banks for

transactions for a bank's own account, as well as to bank customers. If a participating bank chooses to become a customer of FBS, it will enter into a separate customer agreement with FBS. You have represented that the bank's customer relationship with FBS would be governed by this separate agreement, which would contain standard provisions similar to those contained in all other FBS customer agreements. Under no circumstances would the bank be required to use FBS's services for its own securities transactions and no additional liabilities or obligations would attach under the Agreement should the bank become an FBS customer. Given these conditions, we do not object to participating banks entering into a brokerage customer relationship with FBS.

On the basis of the facts and representations set forth in your letter of April 16, 1986 and subsequent correspondence and supporting documentation, and with the understanding that the Agreement accompanying exhibits to be used by FBS will conform to the draft dated February 27, 1987, (all of which correspondence and documents are incorporated herein by reference), we will raise no objection to the participation of national banks in the FBS Program. We wish to emphasize that all conditions stated in the INVEST letter, particularly with respect to the limitation of program activities to those permissible for national banks, and the restriction of participating banks' liabilities to the revenues due the banks under the agreement, as well as all conditions stated in this letter, are applicable to the FBS Program.

Because this position is based upon the representations made in your letter of April 16, 1986, and subsequent correspondence and documentation, it should be noted that any different facts or conditions might require a different conclusion. In addition, please note that our view is based on current law and regulation and may be subject to revision as future judicial, regulatory or legislative developments warrant. We will, of course, continue to monitor national bank participation in the Program and we reserve the right to modify the views expressed herein or provide additional comments in the future.

Charles M. Horn
Director
Securities & Corporate Practices Division

* * *

408—August 4, 1987

This responds to your request on behalf of *** for the views of this Office regarding ***'s proposal to implement a networking arrangement in connection with its Phase II discount brokerage program under which securities brokerage services are made available on the premises of national banks (the Program). This response is based

on your letters of October 2 and November 5, 1985, and January 13, August 7, and September 8, 1986, and accompanying documentation, as well as related conversations with the staff of the Securities and Corporate Practices Division.

***, a Michigan corporation, is registered with the Securities and Exchange Commission (SEC) as a broker-dealer and is also a member of the New York Stock Exchange, the National Association of Securities Dealers (NASD) and other national stock exchanges. At the present time, approximately thirty-two banks, including twelve national banks, participate in ***'s Phase II discount brokerage program, under which *** provides certain brokerage services, on a fully-disclosed basis, for bank customers. The networking program is implemented through a networking agreement (Agreement) between *** Discount Brokerage Services, a division of ***, and participating Subscribers.¹ The Agreement sets forth the services to be provided by ***, the arrangements concerning shared employees, the provisions for compensation of the Subscribers by ***, the provisions regarding the segregated area each bank will provide for the conduct of brokerage services, provisions regarding conduct of accounts, the provision for indemnification of the subscribing institutions, the requirements concerning advertisement of ***'s services, the provisions concerning the term and termination of the Agreement, and various miscellaneous items.

As you are aware, on June 4, 1985, this Office issued a no-objection opinion concerning a similar proposal by the ISFA Corporation to make the INVEST securities brokerage and investment advisory services program (the INVEST Program) available on the premises of national banks. We have reviewed the proposed activities of the *** Program and have concluded that in all material respects they are identical to the activities of the INVEST Program which were discussed in this 1985 letter.

Under the INVEST Program, as described to this Office by ISFA, a participating national bank enters into a contract with ISFA, which provides for the establishment of INVEST Service Centers (Centers) on bank premises.

¹The networking program was originally designed to take advantage of the so-called "networking" exception to SEC Rule 3b-9, adopted July 1, 1985, which required banks engaged in providing certain securities services to register under the Securities Exchange Act of 1934 ("Act") unless "the bank enters into a contractual or other arrangement with a broker-dealer registered under the Act pursuant to which the broker-dealer will offer brokerage services on or off the premises of the bank . . ." 17 C.F.R. § 240.3B-9(a)(1). Although Rule 3b-9 was declared invalid on November 4, 1986, by the U.S. Court of Appeals for the District of Columbia Circuit, *American Bankers Association v. SEC*, 804 F.2d 739 (1986), Olde has advised us that it wishes to maintain the networking program pending further judicial, legislative or regulatory developments.

The Centers provide brokerage services and standardized investment advice to bank customers through individuals who are dual employees of ISFA and the subscribing bank. ISFA does not purchase or sell securities for its own account or engage in securities underwriting activities. ISFA exercises exclusive control and supervision over the dual employees' conduct of the INVEST business and determines precisely the investment advice to be provided. As compensation for the services of the dual employees (whose salaries are paid by the bank) and for the rental of the space occupied by INVEST, ISFA makes monthly payments to the bank, based upon a fixed percentage (generally 50%) of the revenue attributable to transactions effected at the INVEST Center. ISFA deducts from the monthly payments a portion of the losses incurred as a result of the failure of any customer to meet its obligations to ISFA.

The activities of the INVEST Centers are limited to those which may be performed by national banks under the national banking laws, and the Centers do not effect transactions for the fiduciary accounts of subscribing banks or handle discretionary accounts. The INVEST Program is structured to maintain a strict separation between ISFA's business and that of the subscribing bank. Various provisions have been included in the INVEST Program to assure this separation, including the maintenance of separate records, the segregation of the INVEST Center in a clearly identifiable area of the bank, and written notice to all INVEST customers that the services of the latter are provided by INVEST alone. Further, under no circumstances does bank liability under the INVEST program (limited to customer failures to meet obligations) exceed the amount of revenue-sharing payments payable to the bank from program-related securities transactions. For a more complete description of the INVEST Program, see Letter from Richard V. Fitzgerald, Chief Counsel, to Thomas A. Russo (June 4, 1985) (the INVEST Letter) and supporting submissions.

It is well established that national banks may lease their excess office space to others pursuant to 12 U.S.C. §§ 29 and 24 (Seventh). See *Wirtz v. First National Bank & Trust Co.*, 365 F.2d 641, 644 (10th Cir. 1966); *Wingert v. First National Bank*, 175 F. 739, 741 (4th Cir. 1909), *appeal dismissed*, 223 U.S. 670 (1912); *Brown v. Schleier*, 118 F. 981, 984 (8th Cir. 1902), *aff'd*, 194 U.S. 18 (1904). Incidental to a national bank's power to lease its office space is the authority to establish appropriate lease terms by bargaining for whatever terms are usual and customary in the leasing of commercial office space. See Interpretive Letter No. 294 from Brian Smith, Chief Counsel (Dec. 2, 1983), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,438. As a result, the Office concluded in Interpretive Letter No. 294 that a bank may lease excess space in its lobby to an insurance agent, and receive rent in the form of a percentage of the insurance agent's volume of sales or gross

...to the rented lobby space. See *id.* Renting lobby space under such a "percentage lease" is conditioned on the observance of the precautions enumerated by Interpretive Letter No. 294, such as the requirement that the lessee's business be appropriately and separately identified "to ensure that all aspects of the leasing relationship are in accord with federal banking laws and safe and sound banking practices."

Since the lessee addressed by Interpretive Letter No. 294 was not a bank employee and did not propose to employ bank employees to sell the lessee's products and services, the Interpretive Letter did not address the circumstances under which a national bank could share its employees with a party renting lobby space under a percentage lease. With the subsequent issuance of the INVEST Letter, the Office indicated that the combination of percentage leasing with employee sharing does not give cause of objection where the employees of the bank and the lessee on bank premises are only performing activities that are permissible for national banks.

In considering the authority of national banks to participate through the use of shared employees in brokerage services programs such as the INVEST Program and the instant one proposed by Olde, we note that the authority of national banks to provide brokerage services is conclusively established. See *Securities Industry Association v. Comptroller of the Currency*, 758 F.2d 739 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 790 (1986) (brokerage issue), *rev'd*, 107 S. Ct. 750 (1987). Further, in accordance with the incidental powers clause of 12 U.S.C. § 24 (Seventh), national banks may exercise all powers incidental to the business of banking. Programs such as those offered by ISFA and *** when conducted in compliance with the national banking laws, enable a national bank to make authorized brokerage services available on its premises through use of its employees, particularly under circumstances where it may not be practical or efficient for the bank to provide the services directly to its customers. When economic, geographic or other reasons make advisable the providing of such services but the demand for them is uncertain, or the subscribing bank does not wish for other reasons to commit its own resources to the establishment of a brokerage department or an operating subsidiary, the use of bank employees in this type of program may offer the Bank a low-cost, low-risk alternative way of providing such brokerage services to its own customers. Accordingly, the Office is of the view that national banks' use of dual employees in such programs, as described herein and in the INVEST Letter is incidental to the provision of an authorized banking service — brokerage — and is therefore authorized as part of the business of banking under 12 U.S.C. § 24 (Seventh). See *Wyman v. Wallace*, 201 U.S. 230, 243 (1906) (authorizing activity that relates to demands of bank's business and is not expressly prohibited by na-

tional banking act), *Miller v. King*, 223 U.S. 505, 511 (1912) (authorizing activity that is not so disconnected with banking business as to violate 12 U.S.C. §24 (Seventh), *Clement National Bank v. Vermont*, 231 U.S. 120, 140 (1913) (authorizing activity that promotes the convenience of the bank's business). See generally *M&M Leasing Corp. v. Seattle First National Bank*, 563 F.2d 1577 (9th Cir. 1977), *cert. denied* 436 U.S. 956 (1978); *American Insurance Association v. Clarke*, 656 F. Supp. 404 (D.D.C. 1987), *appeal pending*, No. _____ (D.C. Cir. 1987).

We also note that the use of dual employees in these brokerage programs will not cause participating banks to violate Section 32 of the Glass-Steagall Act, 12 U.S.C. § 78, which prohibits, *inter alia*, employees of an organization "primarily engaged in the issue, flotation, underwriting, public sale, or distribution . . . of stocks, bonds, or similar securities" from serving simultaneously as employees of member banks of the Federal Reserve System (*i.e.*, national banks). The Supreme Court has approved the Federal Reserve Board's longstanding position that the securities activities described in Section 32 do not include brokerage transactions conducted as agent for customers. See *Securities Industry Association v. Board of Governors of the Federal Reserve System (Schwab)*, 468 U.S. 207, 218-219 (1984) (interpretation of identical language contained in Sections 20 and 32 of Glass-Steagall).² As indicated, the brokerage services that are provided through the INVEST and the *** Programs are limited to activities which are authorized for national banks, and are provided on an agency basis only. Since it is established that the prohibitory language of Section 32 does not encompass these securities activities, it is clear that Section 32 does not preclude a national bank's use of the dual employees as part of the INVEST Program or the brokerage program described herein.

The *** Program, as described in your several letters and supporting submissions, resembles the INVEST Program in numerous material respects, except that ***'s program is limited to brokerage activities and, unlike INVEST, does not include investment advisory services. There are, in addition, several other points of difference between the two, which we have concluded are not material and do not affect the authority of a national bank to participate in the program.

1) Market-making

*** acts as a market-maker and maintains a dealer's inventory in approximately a dozen over-the-counter

²We have also considered (see next section) whether market-making activities, which are not conducted on bank premises and which are available only to its retail customers, raises an affiliation question under Section 32 when considered in light of the employee-sharing arrangement. We conclude, for the reasons discussed, that these activities will not trigger a violation of this statutory provision.

stocks and has recently participated as an underwriter in at least two corporate bond issues. Your letter of September 8, 1986 noted that the securities in which *** makes a market are recommended only to its own retail customers and are not promoted to customers of the Subscribers. You further pointed out that since Subscribers have no equity interest in *** and are not carrying any securities inventory, the banks take no principal risks in such transactions. Because a national bank generally cannot be a market-maker in corporate stocks or an underwriter of corporate bonds, these activities cannot be included as part of the *** brokerage program on national bank premises. Indeed, the program will be limited to the delivery of only those securities services which are permissible for national banks. Therefore, subscribing national banks may not participate in any securities transactions in which *** acts as a market-maker; such transactions may only be effected on bank premises by *** as agent for customers.

In addition, we note that ***'s activities as a market-maker, together with its arrangement to share employees with Subscribers, may raise an affiliation question under Section 32 of the Glass-Steagall Act, 12 U.S.C. § 78 (see above). It is not clear that Section 32 would apply to market-making, inasmuch as the prohibition in the statute applies to employees engaged in certain specifically enumerated activities (i.e., issue, flotation, underwriting, public sale and distribution) and does not refer to market-making or dealing. Since the plain language of the statute does not prohibit interlocking employment between banks and any entity primarily engaged in market-making, there is some doubt whether ***'s activities in this area would trigger application of Section 32. See *Schwab, supra*, 468 U.S. at 218-219, in which the Supreme Court referred to the general principle that statutes should be interpreted according to their "plain language." Since the Congress which enacted the Glass-Steagall Act omitted "market-making" or "dealing" from the prohibition of Section 32 while specifically including "dealing" in Section 16, 12 U.S.C. § 24 (Seventh), it is uncertain whether Congress intended Section 32 to apply to these activities.

We need not resolve this question at this time, however, because ***'s market-making activities form only a small percentage of its total securities business. Therefore, we do not believe that *** is "primarily" engaged in the activities described in Section 32; hence, we do not believe that the program as structured violates this pro-

vision.⁴ However, it will be the Subscribers' responsibility to ensure that they do not at any time become involved in any situation which could precipitate a violation of Section 32.

2) Advertising and promotion

Paragraph 23 of the Agreement, which states that "**** shall assist [the bank] in the promotion and marketing of this brokerage services program," might be interpreted as making subscribing banks primarily responsible for such activities, particularly since, as the Agreement is presently written, the latter bear all advertising costs. While this Office does not object to Subscribers retaining the option to sponsor their own advertising in connection with the program, in those cases where the bank does so, any resulting liability must be limited to the revenue payments due to the bank under the Agreement.

3) Liability

Banks which participate in the *** Program may elect to follow ***'s risk control procedures, in which case *** bears the liability for losses caused by customer default. Subscribers may also elect to use their own risk control procedures, in which case an officer of the bank is issued a special approval code to use on transactions not within ***'s central approval guidelines. Since banks exercising the latter option would thus be exposing themselves to potentially unlimited losses from failed transactions, you have agreed, in your letter of September 8, 1986, that the special approval code (i.e., the bank's right to approve transactions outside ***'s central approval guidelines) will be used in only two instances: a) where the customer has sufficient equity in his bank account to satisfy ***'s risk control criteria on a buy transaction, and b) where the customer has delivered securities to the bank on a sell transaction. The Agreement will reflect these changes.

In the first case, the bank can debit the compensating balance in the account in the event of a default, and in the second case, the bank can avoid loss merely by ascertaining that it has received securities in deliverable form. Since these limitations on the bank's right to use its own trade approval procedures will shield the bank from potentially unlimited liability, the Office will not object to the Subscribers having the option to use those procedures.

³Section 16 is the only portion of the Glass-Steagall Act which refers to dealing. Section 21, 12 U.S.C. § 378, refers to "issuing, underwriting, selling or distributing . . ." Section 20, 12 U.S.C. § 377, refers to the "issue, flotation, underwriting, public sale, or distribution . . . of . . . securities."

⁴This Office has previously taken the position that the phrase "primarily engaged" in § 32 does not denote a quantitative measurement but means only "substantially engaged," and that the determination of whether an organization is "primarily engaged" in any of the named activities should be made based on the particular circumstances bearing on "substantiality." See Interpretive Letter No. 383 (January 29, 1987).

4) Pricing structure

The monthly payments to the banks from *** consist of a percentage of the brokerage commissions received after transaction costs have been deducted (the exact percentage to vary depending on the type of transaction and/or whether the Subscriber has its own order-entry equipment or telephones the orders to *** for execution). In addition while *** will not pay any transaction-related or other compensation to the registered representative bank employees, Subscribers may choose to pay these employees some sort of incentive bonus based on the amount of commissions earned, in addition to their regular bank salary. The issue raised by this pricing structure is whether the use of transaction-based compensation for either the bank or its employees results in the creation of an impermissible partnership relationship between *** and the subscribing bank.

As a rule, a national bank lacks the power to enter into a general partnership which results in the bank's having unlimited liability for the debts of its partners. *Merchants National Bank v. Wehrmann*, 202 U.S. 295 (1906). In determining whether a partnership exists, the right to a portion of the profits of a business (i.e., proceeds after deduction of expenses) normally creates the presumption of a partnership — a presumption which does not arise when only gross returns are shared.⁵ An agreement to share both expenses and income, as is the case here, where Subscribers are responsible for such costs of the program as advertising costs, training fees and transaction charges, might be considered profit-sharing and thereby raise the partnership presumption. An exception to this rule arises, however, if the profits are received either as compensation for services or as rent, in the form of a percentage lease.⁶

Both of these exceptions would seem to apply to the brokerage program. The monthly payments which Subscribers will receive from the total program revenues represent its share of profits from the program. Any bonuses or transaction-related compensation which Subscribers might pay the employee representatives would fall within the exception to the general presumption of a partnership created by profit-sharing where profits are received as compensation for services. The monthly payments to the Subscribers, which represent compensation for ***'s use of bank space and the employee's services,

appear to fall within the exception to the presumption of partnership where such payments are received as both rental payments and employee compensation.

Finally, while we believe that subscribing banks would not be considered general partners of *** under the UPA and general principles of partnership law, the resolution of this question is ultimately a matter of state law, and may vary from state to state. We also note that it is possible that the bank's relationship with *** might be construed as a limited partnership in certain states, with the bank having the status of a limited partner. Since *Wehrmann* "is based wholly and exclusively upon the unlimited liability exposure of a general partner," the Office has permitted national banks to become limited partners in banking-related ventures. Interpretive Letter No. 289 from Michael Patriarca, Deputy Comptroller (May 15, 1984), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,453. See also Letter from Charles F. Byrd, Assistant Director, Legal Advisory Services Division (July 1, 1981); Letter from Eugene Mar-sico, Jr., Attorney (July 15, 1985). Thus, even if a national bank were deemed to be a limited partner in the *** Program, the bank would be acting within its authority since the *** Program is limited to the permissible bank activity of securities brokerage. In any event, participating national banks are advised to consult applicable state law on the questions of partnership criteria, and are further reminded of their responsibility for ensuring that they do not incur general partnership liability as a result of their participation in the *** Program.

On the basis of the facts and circumstances set forth in your letters of October 2 and November 5, 1985, and January 13, August 7, and September 8, 1986, and supporting documentation, and with the understanding that the Agreement and other documents to be used by *** (including the Memorandum of Understanding to be signed by employee representatives) will conform to those submitted to use as modified by the representations in your letter of September 8, 1986 (all of which letters and documents are incorporated herein by reference), and with the qualifications expressed herein, we will raise no objection to the participation of national banks in the *** Program. We wish to emphasize that all conditions stated in the INVEST Letter, particularly with respect to the limitation of program activities to those permissible for national banks, and the restriction of participating banks' liabilities to the revenues due the banks under the agreement, as well as all conditions stated in this letter, are applicable to the *** Program.

Because this position is based upon the representations made in your several letters and supporting documentation, as noted above, it should be noted that any different facts or conditions might require a different conclusion. In addition, please note that our view is based on current law and regulation and may be subject to revision

⁵See Uniform Partnership Act ("UPA") § 7(3) and 7(4) (adopted in every state except Louisiana) J. Crane and A. Bromberg, *Law of Partnership* § 14, pp. 66-69 (1968).

⁶The Office has generally permitted banks to bargain for whatever terms are usual and customary in the leasing of commercial office space, provided that the percentage required is not unusually high and the bank does not exercise control over the lessee's business. See, e.g. Interpretive Letter No. 294, *supra*.

as future judicial, regulatory or legislative developments warrant. We will, of course, continue to monitor national bank participation in the program and we reserve the right to modify the views expressed herein or provide additional comments in the future.

Charles M. Horn
Director
Securities & Corporate Practices Division

* * *

409—January 11, 1988

This is in response to your letter dated November 7, 1987, in which you request a No-Objection response relating to the Depository Institutions Management Interlocks Act (hereinafter the Interlocks Act). 12 U.S.C. § 3201 *et seq.*

Your inquiry concerns the proposed service of ***, currently a director of TC, a company chartered by the State of Illinois, on the Board of Directors of NB, a national bank. TC and NB are not affiliated institutions, and TC's business activities do not include accepting demand deposits or making commercial loans. The issue presented, therefore, is whether the provisions of the Interlocks Act and its implementing regulations will prohibit *** from serving as a director on the boards of both entities. See 12 U.S.C. § 3201 *et seq.* and 12 C.F.R. § 26 *et seq.*

You indicated in recent letters to this Office that TC and NB have a very limited business relationship. TC provides title insurance in some of NB's real estate loan transactions. Outside of this relationship, however, TC and NB do not intend to enter into any future contractual service arrangements.

You state that NB is interested in *** serving as a director solely because of the substantial personal contribution he could make to the bank's management. You stated in your December 3, 1987, letter that ***'s position with TC is "coincidental" in this instance, and that it has not influenced NB's decision in nominating him for the position of director. Notwithstanding these facts, the potential interlocks violation must be addressed.

The Interlocks Act seeks to promote competition by generally prohibiting a management official of a depository institution or depository holding company from serving as a management official of any other depository institution or depository holding company. "Since financial institutions provide the lifeblood of communities — money and credit — the public's need for laws to assure a safe, sound, and responsive financial system is obvious . . . When these bank services are lost or diminished through . . . anti-competitive situations . . . the impact on a com-

munity and a neighborhood can be severe 1978 U.S. Cong. & Admin. News 9273, 9281.

The objective of the Interlocks Act is achieved by placing restrictions on the management officials of depository organizations.¹ These restrictions relate to the institutions' geographic location and asset size. See 12 U.S.C. §§ 3202, 3203 and 12 C.F.R. § 26.3 More specifically the statute prohibits an individual from serving as a management official for two nonaffiliated depository organizations if both are located in the same community, or if both are located in the same metropolitan statistical area and either institution has assets over twenty million dollars. The Interlocks Act also prohibits management officials from serving two or more depository organizations when one depository organization has total assets exceeding \$1,000,000,000 and another has total assets exceeding \$500,000,000.

A basic precondition for the application of the Interlocks Act is the involvement of a depository organization. This statute does not prohibit interlocking directorates for non-depository organizations. You assert that the Interlocks Act does not apply to the proposed service of *** because TC is not a depository institution. You suggest that the activities of TC prevent it from qualifying as a depository institution. A review of the Interlocks Act and its legislative history causes me to reach the same conclusion.

Although section 3201 of Title 12, United States Code, expressly includes "trust companies" within the definition of a depository institution, I submit Congress did not intend to include those trust companies which do not extend credit or provide deposit taking services. The statute lists several institutions as depository institutions. They include: a commercial bank, a savings bank, a trust company, a savings & loan association, a building and loan association, a homestead association, a cooperative bank, an industrial bank, or a credit union. All of these enumerated institutions either actually provide or may provide financial services to a community. As the previously quoted excerpt suggests, Congress wanted to ensure that financial services, specifically deposit and credit services, which were vital to the "lifeblood of communities" continued to be provided in a competitive manner. They recognized that "[a]nticompetitive interlocks can have an impact on the flow of credit and financial policies and practices to the detriment of communities, neighborhoods and small businessmen, home buyers, farmers, consumers, and others in need of credit on the best terms possible." 1978 U.S. Cong. & Admin. News 9273, 9286.

¹The term "depository organization" is defined in the Interlocks Act implementing regulations as "a depository institution or a depository holding company" 12 C.F.R. § 26.2(g)

Thus Congress intended within the definition of depository institutions those organizations which either did or could accept deposits from natural persons and extend credit to a community.

A trust company may properly be included within the category of depository institutions since such institutions may be authorized by laws of certain states to make extensions of credit and accept deposits from individuals. But you have represented that TC does not now and will not accept deposits or make commercial loans. Therefore, TC's activities will not make it a provider of financial services that will place it in competition with other "depository institutions." Because the TC and NB relationship will not affect competition for individual deposits or extensions of credit within a community, prohibiting this relationship based upon a literal reading of the statute, is not, in my opinion, in accordance with the Congressional intent. "An instrument must always be construed as a whole, and the particular meaning to be attached to any word or phrase is usually to be ascribed from the context, the nature of the subject matter treated of, and the purpose of intention of the . . . body which enacted or framed the statute or constitution. Neither clinical construction nor the letter of the statute nor its rhetorical framework should be permitted to defeat its clear and definite purpose to be gathered from the whole act, compared part with part."² Accordingly, ***'s service on the boards of TC and NB should not be prohibited because TC is not a depository institution under the Interlocks Act.

In discussing the Interlocks Act prohibitions the legislative history states at page 9277:

Title II-Interlocking Directors: Prohibits interlocking directors among depository institutions (banks, savings and loan associations, credit unions, and mutual saving banks) . . . (1978 U.S. Cong. & Admin. News 9273, 9277.)

It also provides that:

1. [Interlocks Act] expands the present prohibition on bank-to-bank interlocks to include interlocks between all kinds of depository institutions — banks, savings and loans, credit unions, mutual savings banks, and their holding companies . . . (*Id.* at 9286.)

The Interlocks Act's legislative history includes a discussion of the statute's possible application to nondepository organizations which are in competition with depository organizations. The discussion specifically concerned the activities of insurance companies. Some Congress-

men, including Chairman St Germain, were concerned that the failure to include nondepository organizations under the Interlock Act created a dangerous loophole which could ultimately jeopardize the effectiveness of the Act. The Justice Department stated that it could not prosecute such anti-competitive situations since the Clayton Act did not pertain to banks, banking associations and trust companies. Therefore, notwithstanding the fact that common management official relationship between depository organizations and nondepository organizations could have anti-competitive consequences, there was no legal prohibition against such a relationship.

Congressman St Germain introduced an amendment which would include prohibitions on directorate activities between depository and nondepository organizations. This attempt to amend the legislation was not successful, however. 124 Cong. Rec. 33,816 (1978) (statements of Chairman St Germain and Congressman McCormack).

Congress decided not to broaden the scope of the Interlocks Act to situations involving competing depository and nondepository organizations. It was stated that such action would exceed the purpose of the Interlocks Act and be a circuitous attempt to amend the Clayton Act. 124 Cong. Rec. 33, 817 (1978) (statement of Congressman Brown).

Congress acknowledged that "tight membership in boards of directors" could stifle innovation and competition in the financial community. However, the legislative history reveals that including nondepository organizations within the Act's prohibitions, would exceed the statute's purpose. The minority's view succinctly describes the concern: "The primary concern of the minority with regard to this title has been to make certain that the conflicts of interest involved in some interlocking directorates will be adequately regulated. However, it is also imperative that the legislation permit sufficient flexibility to allow the vast pool of expertise available in the financial community to work together in a procompetitive atmosphere. The minority believes that these two goals have been achieved in this bill." 1978 U.S. Cong. & Admin. News 9273, 9370 (emphasis added).

These excerpts reveal Congress' intent to apply the Interlocks Act to institutions which provide money and credit services to communities, but to do so in a way which also permits flexibility to encourage the exchange of human talents. Since the legislative purpose of the Interlocks Act will not be furthered by prohibiting *** from serving on the boards of NB and TC, I will recommend that this Office take a no-objection position.

Charles F. Byrd
Assistant Director
Legal Advisory Services Division

²1. *Singer, Sutherland and Statutory Construction* § 4605 (4th Ed.)

Edward J. Kelly, III, Esq.
Davis, Polk & Wardwell
1575 Eye Street, N.W.
Washington, D.C. 20005

Re: Mexican Exchange offer

Dear Mr. Kelly:

This is in response to your letter dated January 13, 1988, requesting this Office's view on certain issues related to the participation of national banks in an offer by the United Mexican States (UMS) to exchange certain outstanding debt for new bonds (Exchange Offer). Specifically, you request confirmation of the treatment of a bank's participation in the Exchange Offer for purposes of its statutory investment or lending limits under 12 U.S.C. §§ 24 (Seventh) or 84. You also request confirmation that the bonds received in the Exchange Offer qualify as investment securities for acquisition by national banks under 12 U.S.C. § 24 (Seventh).

Background

Our understanding of the Exchange Offer is based upon your description in your request letter and upon additional information supplied by the Morgan Guaranty Trust Company.

In the proposed Exchange Offer, the United Mexican States (UMS) intends to offer to all creditors under its public sector restructuring and new money agreements the opportunity to exchange existing indebtedness for new bonds (the Bonds) to be issued by UMS. The Bonds would be exchanged for debt obligations of the UMS and/or debt obligation of other public sector borrowers which are guaranteed by the UMS.

The Bonds will be issued in registered form and will represent direct and unconditional obligations of the UMS. The Bonds will mature twenty years after the date of issue and will be callable by the issuer at par at any time. The new Bonds will not be subject to restructuring and will not be considered part of the base amount in any potential future requests by the UMS for new money from creditor banks.

The new Bonds will be collateralized as to repayment of principal at maturity by a pledge of a special issue of twenty-year, zero-coupon United States Treasury securities with a face amount equal to the principal of the Bonds. These securities will be purchased by the UMS directly from the United States Government prior to the closing of the transaction specifically for use as collateral. The collateral is not available to cover interest payments

or to cover principal payments prior to final maturity even if the Bonds are accelerated. At the final maturity date the proceeds of the collateral will be available to pay the full principal amount of the Bonds.

The Bonds will bear a market rate of interest, payable semi-annually, at a floating rate equal to a specified percentage over the London interbank offered rate for six-month Eurodollar deposits. Payments of interest on the Bonds will not be collateralized. Principal of and interest on the Bonds will be payable in New York and at certain designated paying agencies outside the United States.

The Bonds will be issued to non-United States banks in the Euromarket. It is anticipated that the Bonds will be listed on the Luxembourg Stock Exchange. The Bonds will be listed for clearance with Euro-clear and CEDEL and will be fully marketable upon issuance, subject to normal Eurodollar procedures designed to ensure that the Bonds come to rest outside of the United States. The Bonds will be issued to United States banks on a private placement basis within the United States. The Bonds will be tradeable in the private placement market unless they can be otherwise sold in a transaction which is exempt from the registration requirements of the Securities Act of 1933. The Bonds will be issued in minimum denominations of \$250,000 in the United States.

Request

You request our views, first, on the effect of participation in the Exchange Offer on a participating national bank's compliance with statutory investment and lending limits. The Exchange Offer involves the issuance of UMS Bonds in exchange for existing debt obligations of UMS and other public sector borrowers. You represent that, as a result, a national bank that participates in the Exchange Offer may receive Bonds that — either in themselves or in combination with other debts of UMS to that bank — would exceed the bank's lending limit on loans to one obligor under 12 U.S.C. § 84, or its investment limit on investment obligations of one obligor under 12 U.S.C. § 24 (Seventh), or the combined limits thereof. However, in the Exchange Offer, participating banks will not be extending new money.

In your opinion, the Office should treat a national bank participating in the Exchange Offer (that is, a bank which as a result of the Exchange Offer would hold new and preexisting obligations of UMS in a total amount that exceeds the bank's legal limit) in the same way as the Office viewed an Argentine debt exchange program discussed in OCC Letter No. 288 (April 25, 1984), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85, 452, and the Mexican FICORCA Facility Agreement discussed in an OCC Letter dated August 11, 1987 (unpublished). In those letters, the Office stated that it would not consider a national

bank to be in violation of 12 U.S.C. § 84 by virtue of the substitution of a centralized obligor in an exchange program for existing debt. At most, such national bank would be placed in a "nonconforming" situation which would limit the extent to which it could make subsequent new extensions to the obligor.

You also request our concurrence that the Bonds would qualify as "investment securities" eligible for acquisition and holding by national banks under 12 U.S.C. § 24 (Seventh). In view of the various features of the Bonds and the circumstances of the proposed Exchange Offer, you believe the Bonds should be regarded as an investment security because they will be obligations in the form of an investment security (*i.e.*, bonds), they will be marketable and they will not be investments which are predominantly speculative in nature. See 12 C.F.R. § 1.3(b). You maintain it would be reasonable to conclude that the Bonds would have the requisite degree of marketability. In support of this conclusion, you point to the substantial size of the offering, the anticipated large number of foreign and United States banks that will acquire the Bonds, and the anticipated development of an institutional secondary market, among other factors. You also observe that, in view of the fact that the Bonds will be collateralized as to principal by United States Treasury securities, the repayment of the principal of the Bonds at maturity will be assured and thus would not be viewed as predominantly speculative. While interest payments are not collateralized, you represent that UMS and other Mexican public sector entities have approximately \$2 billion of publicly issued debt outstanding, all of which has been excluded from restructuring and has been serviced and continues to be serviced on a current basis as to principal and interest. The terms of the proposed new Bonds state they will not be subject to restructuring. You also note estimates that, because of the reduction in total outstanding debt resulting from the Exchange Offer, the Exchange Offer will reduce Mexico's external debt service requirements over the life of the Bonds.

Based on the foregoing factors, you believe the Bonds would qualify as investment securities and would thus be eligible for purchase and holding by a national bank up to 10% of the bank's capital and surplus under 12 U.S.C. § 24 (Seventh). See *also* 12 C.F.R. § 1.3(e) ("Type III" securities).

Opinion

With respect to a national bank participant in the Exchange Offer the OCC will not consider a national bank to be in violation of 12 U.S.C. § 84 or 24 (Seventh), if, by virtue of its participation in the Exchange Offer and receipt of Bonds, such bank as a result holds total obligations of UMS in excess of its legal limits. At most, such national

bank would be placed in a "nonconforming" situation which would limit the extent to which it could make subsequent new extensions to UMS.

A bank participating in the Exchange Offer may decide to hold the Bonds received either under its lending authority (as an extension of the preexisting lending relationship) or under its investment authority, as discussed below; but it may not hold the Bonds in both categories simultaneously. Such an election is a one time event and should be made at the time of acquisition. If the Bonds received by a bank in the Exchange Offer are treated as investment securities by that bank, the question of nonconforming treatment under section 84 may not arise; but amounts received in excess of the Bank's investment limit will be accorded nonconforming status under that limit. However, if at the time of the Exchange Offer a bank does not choose to make such a determination, but holds the Bonds under its lending authority as nonconforming assets, then section 84 would be implicated. While banks may hold those Bonds received in the Exchange under their lending authority, we do not believe banks may purchase additional Bonds in the secondary market under their lending authority. Thus, the only rationale under which it is clear that banks may purchase additional Bonds is under their investment authority. Similarly, banks that do not participate in the Exchange Offer may only purchase Bonds in the market under their investment authority.

With respect to a determination that the Bonds qualify as investment securities, particularly with respect to the acquisition of Bonds subsequent to the Exchange, we believe the factors you have identified and the other characteristics and circumstances of these Bonds would be sufficient to support a determination by a bank that these Bonds qualify as Type III investment securities. See 12 C.F.R. §§ 1.3(b), 1.5, 1.8. It is the responsibility of each bank to make this determination in light of the circumstances prevailing at the time of its acquisition of any Bonds. At the present time at least, such a determination must, however, be based to a substantial extent upon estimates believed to be reliable and anticipated future developments. See 12 C.F.R. § 1.5(b). For this reason, a bank's holding of these Bonds as investment securities will be subject to the limitations of 12 C.F.R. § 1.7(b). Accordingly, a bank's holding of these Bonds and any other securities may not exceed the aggregate five percent of the bank's capital and surplus.

In responding to your inquiries, this Office is not taking any position on bank participation in the Exchange Offer, which remains a matter that is the responsibility of each bank management. We also note that any material alterations in the implementation of the Exchange Offer or other material changes and developments regarding the

Bonds may affect the Office's analysis of the Exchange Offer and the Bonds in the future.

Robert J. Herrmann
Senior Deputy Comptroller
for Bank Supervision Policy

* * *

411—January 20, 1988

This is in response to your letter dated July 17, 1987, notifying this Office pursuant to 12 C.F.R. § 5.34 of the proposal of *** (Bank), to expand the activities of *** (Subsidiary), an existing wholly-owned operating subsidiary of the Bank. As proposed by the Bank, the Subsidiary would enter into a general partnership, *** (Partnership), that would make short-term bridge loans to finance merchant banking transactions, such as leveraged buy-outs, tender offers, and recapitalizations. As an adjunct to the proposed lending activity, the Partnership might also provide financial advice regarding short- and long-term financing of merchant banking transactions. Based on the facts, assumptions, and conditions stated here and in your notification letter, we are not objecting to the Bank's proposal, which therefore may be implemented pursuant to 12 C.F.R. § 5.34.

Bank's Proposal¹

Structure of Partnership

The Subsidiary would be a general partner with a fifty percent interest in the Partnership; a second general partner would hold the remaining fifty percent interest in the Partnership. The second general partner, described as an affiliate of *** (Investment Bank), would be a non-depository institution.

Responsibility for the management, direction, and control of the partnership would be vested in an Executive Committee composed of eight Members. Each partner would appoint four Members to the Executive Committee. All decisions of the Executive Committee, including all credit decisions, would require an affirmative vote of no less than five Members. Thus, each partner would have effective veto power over actions proposed by the other partner.

The Partnership agreement submitted to us expressly provides that the Partnership could not perform activities unless they are permissible for a national bank or its

operating subsidiary, and that the Partnership shall be subject to supervision and examination by the Office. Thus, the Subsidiary could not be precluded by the other partner from having the Partnership's activities conform to the national banking laws, including any condition imposed herein pursuant to 12 C.F.R. § 5.34, or from having the Partnership be supervised and examined by the Office.

Partnership Activities

The Partnership would be formed for the purpose of making bridge loans to finance merchant banking transactions. Bridge loans, you note, are short-term extensions of credit provided to acquirers or corporate management to allow tender offers and other merchant banking transactions to be completed promptly without the delay involved in negotiating permanent financing. In a typical bridge loan transaction, the lender is repaid within six months to one year upon the completion of permanent senior term debt financing and subordinated term debt financing.

Before bridge financing is extended by the Partnership, each partner would conduct a credit analysis encompassing the credit criteria identified by your letter. One purpose of the credit analysis would be to ensure, as you write, that the "Partnership will only extend bridge financing in circumstances where there is a strong expectation that 'take out' financing will be forthcoming." In particular, before bridge financing is committed or extended by the Partnership, the borrower will have obtained a "highly confident" letter from an investment bank as to its ability to underwrite and sell the borrower's debt or equity securities, and a "highly confident" letter from a bank lender or syndicate as to its commitment to extend long-term senior refinancing. There would be no contractual commitment or obligation for either partner, you add, to provide long-term funding for a borrower. A second purpose of the credit analysis is to ensure that "[i]f refinancing is delayed, the Partnership will have conducted an in-depth credit analysis to assure itself that the assets and cash flow of the target company and the overall liquidation value are sufficient to repay the bridge loan."

Once found acceptable and approved, bridge loans would be extended through a separate "Financing Partnership" to be formed for each borrower by the partners, as the sole and equal general partners of each Financing Partnership.

In the aggregate, each partner would commit up to \$150 million to finance the Partnership's lending activities. Commitments would be sought from a syndicate of banks for an additional \$600 to \$900 million in financing, without recourse to the Partnership or either partner.

¹Our description of the Bank's proposal is based on the information furnished in your notification letter and material attached thereto, and on additional information furnished by telephone to Jonathan Rushdoony of the Legal Advisory Services Division.

The Partnership and each Financing Partnership would lend money for the purposes of 12 U.S.C. § 36 only at the Bank branch where the Partnership is to be located or at another Bank branch.

As an adjunct to its described lending activities, the Partnership might also furnish advice on short- and long-term financing of merchant banking transactions, as noted above.

Lending and Investment Limitations

The Bank's proposal is accompanied by the following lending and investment limitations. First, the aggregate amount of the Bank's investment in, and extensions of credit to, the Subsidiary would be limited to fifteen percent of the Bank's capital and surplus at the time of the investment or loan of any funds. The Bank has also advised us of the particular dollar amount it contemplates investing in or lending to the Subsidiary — an immediate capital contribution of \$2.5 million, and future loans and/or contributions of up to \$150 million — and has committed that any further investments or loans, even if within fifteen percent of the Bank's capital and surplus, would only be made with the Office's prior written consent.

Next, total extensions of credit to, and investments in, the Partnership by the Bank and the Subsidiary and other Bank affiliates would be limited to five percent of the Bank's primary capital.

Finally, the Subsidiary's pro rata share (fifty percent) of extensions of credit made by the Partnership would be attributed to the Subsidiary, and then consolidated with the Bank, for the purposes of 12 U.S.C. § 84. However, one hundred percent of a loan by the Partnership would be attributed to the Subsidiary and the Bank to the extent that the loan by the Partnership is funded with money borrowed from the Bank or a Bank affiliate. For example, if the Partnership lent \$100 with \$50 borrowed from the Bank or a Bank affiliate, the amount of the \$100 loan by the Partnership that would be attributed to the Subsidiary and the Bank is \$75: one hundred percent of the \$50 portion funded by borrowings from the Bank or Bank affiliate (\$50), plus fifty percent of the remaining \$50 portion (\$25).

Discussion

Permissibility of Proposed Activities

As an existing operating subsidiary of the Bank, the Subsidiary may expand its activities to include additional activities that are a part of or incidental to the business of banking. See 12 C.F.R. § 5.34(c)-(d). The activities to be conducted by the Subsidiary through the Partnership are permissible banking activities. Making bridge loans to finance merchant banking transactions is a lending activity and thus falls within national banks' express lend-

ing authority under 12 U.S.C. § 24 (Seventh). Furnishing advice on financing the sale, acquisition, or capitalization of a business and other merchant banking transactions is authorized by section 24 (Seventh) as an incident to the business of banking. See Letter from Judith A. Walter, Senior Deputy Comptroller for National Operations, to National Bank (July 17, 1986) (LASD Precedent File No. 15A for 12 U.S.C. § 24 (Seventh)).

An operating subsidiary's entry into a general partnership is also an activity that is authorized by section 24 (Seventh) as an incident to the business of banking. In a number of cases, the Office has permitted an operating subsidiary to enter into a general partnership to perform authorized banking activities pursuant to 12 U.S.C. § 24 (Seventh). The Office's partnership decisions are based on the principle, discussed at length by Interpretive Letter 289, that the prohibition of *Merchants National Bank v. Wehrman*, 202 U.S. 295 (1906), on national banks' entry into general partnerships is based exclusively on the unlimited liability exposure of a general partner, and, therefore, is inapplicable where a bank's operating subsidiary enters into general partnership since the bank would generally be shielded from partnership liability by its subsidiary corporation. See Interpretive letter 289 (May 15, 1984), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,453. Our affirmation here of Interpretive Letter 289 is buttressed by the Bank's analysis of applicable state law and opinion that the Bank's Subsidiary continues to fall outside the narrow circumstances that must exist under state law before a court might pierce the separate corporate structure of a subsidiary corporation in order to subject the parent's assets to claims against the subsidiary.

Moreover, the Office has specifically permitted an operating subsidiary to form a general partnership with a non-depository institution under certain circumstances. See Interpretive Letter 346 (July 31, 1985), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,516; Interpretive Letter 369 (Sept. 25, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,539; Interpretive Letter 381 (May 5, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,605. In the case of Interpretive Letter 346, for example, the Office permitted such a partnership where the following factors, which were found to address the Office's legal, policy, and prudential concerns, were present:

- the operating subsidiary and the non-depository institution each owned fifty percent of the partnership as its sole general partners;
- each partner separately appointed an equal number of the partnership's managers;
- the partnership decisions required the vote of no less than a majority of the partnership's managers, giving the bank's subsidiary effective veto power over partnership decisions;

- the partnership agreement stated that the partnership would be subject to Office supervision and examination, and that the partnership could not conduct activities that are impermissible for national banks; and
- the total commitment by the bank and its affiliates to the partnership, including contributions and extensions of credit to the partnership, was limited to five percent of the bank's primary capital. See Interpretive Letter 346, *supra*.

The Bank's proposal for the Subsidiary to form a general partnership with a non-depository institution is accompanied by all of the above factors, and therefore addresses the basic legal, policy, and prudential concerns of the Office concerning such partnerships. See Interpretive Letters 346 and 289, *supra* (discussing the Office's concerns regarding partnerships in general and concerns regarding partnerships with non-depository institutions in particular).

To ensure that the Bank's proposal addresses the Office's legal, policy, and prudential concerns with partnerships that conduct lending activities, the Bank has structured its proposal to contain the same limitations on extensions of credit by the Partnership as were present in the proposal approved by Interpretive Letter 369. See Interpretive Letter 369 (September 25, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,539 (involving a partnership that extended credit by leasing personal property). In particular, the Bank has committed that for the purposes of 12 U.S.C. § 84 the Subsidiary's pro rata share (fifty percent) of extensions of credit by the Partnership will be attributed to the Subsidiary and then consolidated with the Bank, but that one hundred percent of credit extended by the Partnership will be attributed to the Subsidiary and the Bank to the extent that the credit is financed with funds borrowed from the Bank or a Bank affiliate. The Bank has also committed that money would be lent for the purposes of 12 U.S.C. § 36 only at a Bank branch.²

Finally, the Bank's proposal incorporates limitations on total commitments to the Subsidiary that are the same limitations imposed by the Office in two recent decisions, Interpretive Letters 381 and 382. See Interpretive Letter 381 (May 5, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,605 (concerning partnership with non-depository institutions); Interpretive Letter 382 (May 5, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,606 (concerning partnership with depository institutions). In particular, the Bank

has committed that the aggregate amount of the Bank's investment in, and loans or other extensions of credit to the Subsidiary will not exceed an amount equal to fifteen percent of the Bank's capital and surplus at the time of the investment or loan of any funds. The Bank has also advised us of the particular dollar amount it currently contemplates investing in the Subsidiary, and has committed that no additional amounts would be invested in the Subsidiary without the Office's prior approval.³

Applicability of Section 20 of Glass-Steagall

Since the Subsidiary's partner would be an affiliate of the Investment Bank, we have considered whether the proposed Partnership would be prohibited by section 20 of the Glass-Steagall Act, 12 U.S.C. § 377. Section 20 provides:

[N]o member bank shall be affiliated in any manner described in subsection (b) of section 221a of this title with any corporation, association, business trust, or similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities . . . (12 U.S.C. § 377.)

For the purposes of this discussion, we have assumed for the sake of argument that the Investment Bank is "engaged principally" in the securities activities described by section 20. Thus, the remaining question under section 20 is whether the proposed Partnership would cause the Bank to "be affiliated in any manner described in subsection (b)" of 12 U.S.C. § 221a with the Investment Bank.

Subsection (b) of 12 U.S.C. § 221a defines "affiliate" to mean any corporation, business trust, association, or similar organization that meets one of the four tests set forth by subsection (b)(1) through (b)(4). Under the first test, subsection (b)(1), an "affiliate" includes an organization —

Of which a member bank, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 per centum of the number of shares voted for the election of its directors, trustees, or other persons exercising similar functions at the preceding election, or controls in any manner the election of a majority of its directors, trustees, or other persons exercising similar functions. (12 U.S.C. § 221a(b)(1)).

²We did not address in Interpretive Letter 369 whether the subject lending restrictions were necessarily the only ones acceptable for partnership cases, and we do not address that question here. In this case, we note that since the subject limitations presented no cause for objections in Interpretive Letter 369 they present no cause for objection here.

³We did not expressly address in Interpretive Letters 381 and 382 whether all or certain classes of partnership proposals must be accompanied by the subject limitations on a bank's loans to and investments in the subsidiary that serves as a corporate shield between a bank and a general partnership. We need not address this matter here since the Bank has structured its proposal to conform with Interpretive Letters 381 and 382.

Subsection (b)(1) is inapplicable since the pending proposal would not cause the Bank directly or indirectly, to own or control a majority of the Investment Bank's voting shares or more than fifty percent of the shares voted at the most recent election of the Investment Bank's directors or like persons, and would not cause the Bank to control in any manner the election of a majority of the Investment Bank's directors or like persons.⁴

Subsection (b)(2), the second test of "affiliate" status, applies to an organization —

Of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a member bank who own or control either a majority of the shares of such bank or more than fifty per centum of the number of shares voted for the election of directors of such bank at the preceding election, or by trustees for the benefit of the shareholders of any such bank. (12 U.S.C. § 221a(b)(2).)

Subsection (b)(2) does not apply here since the Bank's parent holding company, the shareholder that owns or controls a majority of the Bank's shares, would not control the Investment Bank directly or indirectly through stock ownership in any other manner if the Bank's proposal were implemented.

Subsection (b)(3), the third test, defines "affiliate" to include an organization —

Of which a majority of its directors, trustees, or other persons exercising similar functions are directors of any one member bank. (12 U.S.C. § 221a(b)(3).)

The Bank's proposal would not cause a majority of the Investment Bank's directors or similar persons to be directors of the Bank. Thus, subsection (b)(3) does not apply here.⁵

⁴In regard to the relationship between the Bank and the Partnership, the Partnership would not be an "affiliate" of the Bank under subsection (b)(1) because the Bank would not directly or indirectly possess more than fifty percent control of the Partnership or its managers. Even if the Bank were deemed to be affiliated with the Partnership under subsection (b)(1), the affiliation would not be prohibited by section 20 of Glass-Steagall since the Partnership would not conduct any securities activities, let alone conduct the particular securities activities described by section 20 and be "principally engaged" in such securities activities.

None of the Investment Bank's directors or similar persons would be directors of the Subsidiary and less than a majority of the Investment Bank's directors or similar persons would serve as Partnership managers. Thus, even if subsection (b)(3) were deemed to apply to a case in which a majority of the directors of a "principally engaged" organization are directors of an operating subsidiary or a partnership in which the subsidiary is a general partner, subsection (b)(3) would not apply here.

Finally, subsection (b)(4) includes as "affiliate" an organization —

Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of a member bank at the preceding election, or controls in any manner the election of a majority of the directors of a member bank, or for the benefit of whose shareholders or members all or substantially all the capital stock of a member bank is held by trustees. (12 U.S.C. § 221a(b)(4).)

Nothing in the Bank's proposal would enable the Investment Bank to own or control, directly or indirectly, either a majority of the Bank's shares of capital stock or more than fifty percent of the shares voted at the most recent election of the Bank's directors, or would enable the Investment Bank to control in any manner the election of a majority of the Bank's directors.⁶ Thus, subsection (b)(4), the fourth and final test of affiliate status, is inapplicable here.

In summary, the proposed Partnership would not cause the Bank to become affiliated with the Investment Bank in any manner described by subsection (b) of 12 U.S.C. § 221a. Therefore, the proposed Partnership is not prohibited by section 20 of the Glass-Steagall Act regardless of whether the Investment Bank might be engaged principally in the securities activities described by section 20.

Applicability of Section 32 of Glass-Steagall

The next consideration is whether the Bank's proposal would create an employment interlock with the Investment Bank that is prohibited by section 32 of the Glass-Steagall Act, 12 U.S.C. § 78. Section 32 provides:

No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, primarily engaged in the issue, flotation, under-

⁶Similarly, nothing in the Bank's proposal would enable the Investment Bank to own or control, directly or indirectly, a majority of the Subsidiary's shares or directors. Thus, even if subsection (b)(4) were deemed to apply where a "principally engaged" organization owns or controls a majority of an operating subsidiary's shares or directors, subsection (b)(4) would not apply here. Moreover, nothing in the Bank's proposal would enable the Investment Bank to directly or indirectly own or control a majority of the interests in the Partnership, or to control in any manner the election of a majority of the Partnership's managers. Therefore, even if subsection (b)(4) were deemed to apply where a "principally engaged" organization owns or controls a majority of the interests in, or the managers of, a partnership in which an operating subsidiary is a general partner, subsection (b)(4) would not apply here.

writing, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or similar securities, shall serve the same time as an officer, director, or employee of any member bank. . . . (12 U.S.C. § 78.)

Thus, the terms of section 32 apply where an individual is both (a) an officer, director, or employee of a member bank, and (b) primarily engaged in the securities activities described by section 32 or is an officer, director, partner, or employee of an institution that is primarily engaged in such activities. For the purposes of this discussion, we have assumed for the sake of argument that the Investment Bank is primarily engaged in the securities activities described by section 32.

a. Bank personnel

The first issue the Bank's proposal raises under section 32 is whether any director, officer, or employee of the Bank would become a director, partner, officer, or employee of an institution that is "primarily engaged" in section 32 activities. At the outset, the Bank has made clear that no officer, director, or employee of the Bank would be employed by the Investment Bank. Moreover, none of the Subsidiary's officers, directors, or employees would be employed by the Investment Bank. Thus, we need not consider here whether section 32, which expressly applies to member bank personnel, might also apply to an operating subsidiary's personnel so as to preclude them from being employed by an investment banking firm that is primarily engaged in section 32 activities.

The Subsidiary would appoint as Partnership managers four individuals who are directors, officers, or employees of either the Bank or the Subsidiary or both. However, the Partnership would not engage in any securities activities, let alone conduct the particular securities activities described by section 32 and be primarily engaged in those securities activities.

Since the Partnership would not conduct securities activities, the employment of Bank personnel as Partnership managers could not violate section 32 unless the Partnership and the Investment Bank were deemed to be a "single entity" for the purpose of section 32. In construing section 32, the Federal Reserve Board has found that where two institutions do comprise a single entity, their activities should be combined to determine whether the institutions, when viewed as one entity, may be primarily engaged in the securities activities described by section 32, and, thus, whether member bank personnel may be precluded by section 32 from being employed by either institution. *See, e.g.,* 12 C.F.R. §§ 218.107, 218.108, 218.113. Therefore, if the Partnership and the Investment Bank were viewed as a single entity, Bank personnel could be precluded from being Partnership managers, and we

would address whether the Subsidiary's personnel should be made subject to the same prohibition

In our opinion, the proposed Partnership would be an entity that is separate from the Investment Bank. The Board has found two institutions to comprise a single entity under section 32 where they are so functionally and structurally intertwined that one institution is effectively an arm or department of the other, indicating that their separate organization should be disregarded for the purposes of section 32. *See id.* *See also* 12 C.F.R. § 218.111; *Investment Company Institute v. Camp*, 401 U.S. 617, 625-626 n. 12 (1971). The Investment Bank and the Partnership would not be so functionally and structurally intertwined since the Subsidiary's equal ownership of the Partnership and equal share of Partnership managers would preclude the Investment Bank from having effective control over the Partnership or its managers, and since the Partnership agreement would provide the Subsidiary with effective veto power over any Partnership action proposed by the Investment Bank or its nominees. Therefore, the Partnership and the Investment Bank would be separate entities, and section 32 would not bar the Bank's officers, directors, and employees from serving as managers of the Partnership. Similarly, section 32, if applied to the Subsidiary, would not preclude the Subsidiary's personnel from being Partnership managers.

b. Investment Bank personnel

The second issue the Bank's proposal raises under section 32 is whether the Investment Bank's appointment of four managers to the Partnership would be prohibited. Those managers are assumed by us to be Investment Bank personnel.

Section 32 precludes individuals who are directors, officers, partners, or employees of an institution that is primarily engaged in section 32 activities, or who are primarily engaged in section 32 activities themselves, from being directors, officers, or employees of a member bank. No personnel of the Investment Bank or any other "primarily engaged" institution, and no individuals who themselves are primarily engaged in section 32 activities, would become an officer, director, or employee of the Bank under the Bank's proposal. Moreover, no such person would become a director, officer, or employee of the Subsidiary, and we therefore need not address whether section 32 might preclude such an interlock.

Four Investment Bank personnel would become managers of the Partnership, which would not be a member bank. The express terms of section 32 do not apply to the personnel of a primarily engaged institution unless they are also directors, officers, or employees of a member bank. *See* 12 C.F.R. § 218.1 n. 1. Further, the Federal

Reserve Board has ruled that the personnel of a "primarily engaged" institution will not be precluded from becoming directors, officers, or employees of the parent holding company of a member bank — a bank affiliate that possesses control over the bank — unless the parent and the bank comprise a single entity for the purposes of section 32, and has used its single entity analysis when determining whether section 32 should apply to interlocks with other bank affiliates.⁷ See 12 C.F.R. § 218.114, 1 Fed. Res. Reg. Serv. ¶ 3-889; 12 C.F.R. § 218.111. Accordingly, the personnel of a primarily engaged institution would not be precluded under section 32 from serving as managers of a partnership unless the partnership and a member bank are effectively a single entity. In our opinion, the Bank and the Partnership would not be so functionally and structurally intertwined that they would effectively be a single entity since the Investment Bank's equal ownership of the Partnership and equal share of Partnership managers would preclude the Bank from having effective control of the Partnership, and since the Partnership agreement would give the Investment Bank effective veto power over any Partnership activity. Therefore, the Bank and the Partnership would be separate entities for the purposes of section 32, and the Investment Bank's personnel would not be prohibited from serving as managers of the Partnership. As a result, we do not have cause to condition the Bank's implementation of its proposal on whether Investment Bank personnel will not be Partnership managers.

Applicability of Securities Moratorium of CEBA § 201(b)(2)

Our notification to the Bank is not precluded by the securities moratorium of section 201(b)(2) of the Competitive Equality Banking Act of 1987. During the moratorium period, section 201(b)(2) precludes the Office from authorizing or allowing an insured bank or subsidiary or affiliate thereof to engage in securities activities not legally authorized in writing prior to March 5, 1987. Section 201(b)(2) exempts from the described moratorium certain securities activities, including those which had been lawfully engaged in prior to March 5, 1987.

(a) Investment Bank

In regard to the Investment Bank, the moratorium does not apply because our action here does not authorize or allow the Investment Bank to conduct any activity. Even if our action were deemed to authorize or allow the Investment Bank to conduct an activity and the activity were deemed to be a securities activity that is subject to the moratorium, the securities moratorium would not apply because the Investment Bank is not, and would not

become, an "affiliate" of the Bank for the purposes of the moratorium. See CEBA § 201(c)(1) (defining "affiliate" by reference to section 2(j)(2) of the BHCA); CEBA § 101(a) (adding the referenced "affiliate" definition to the BHCA to include a company that controls, is controlled by, or is under common control with another company). The Investment Bank would not be an "affiliate" of the Bank because neither institution would control the other and because the institutions would not be under common control. Consequently, the securities moratorium could not apply to our discussion of the Investment Bank in this case.

(b) Bank, Subsidiary, and Partnership

The securities moratorium does not apply because we are not authorizing or allowing the Bank, the Subsidiary, or the Partnership to engage in a securities activity. The Office is merely permitting the Subsidiary to enter into a general partnership to conduct lending activities and to advise customers on lending activities. Moreover, a subsidiary's entry into a partnership, even if deemed to be a securities activity for moratorium purposes, is an activity that was both legally authorized in writing and lawfully engaged in prior to March 5, 1987, on several occasions. As a result, the securities moratorium could not apply here.

Conclusion

For the above reasons, the Office does not have cause to object to the new activities proposed for the Subsidiary. The Office is accordingly notifying the Bank pursuant to 12 C.F.R. § 5.34(d)(1)(iii) that the Subsidiary may expand its activities as proposed, subject to the representations, conditions, and assumptions discussed. Our analysis is based on the facts of the specific proposal before us, including your representation that the aggregate amount of the Bank's investment in and extensions of credit to the Subsidiary will be limited to fifteen percent of the Bank's capital and surplus. Different facts in this or another case might give cause for the Office to reach a different results. Our analysis also reflects current legal and prudential standards, and may be subject to revision as future developments warrant. In addition, please note that the following are regarded as new activities for the purposes of the notification requirement of 12 C.F.R. § 5.34(d)(1): investments in the Subsidiary in addition to the particular dollar amounts permitted here, changes in the activities of the Partnership, changes in the Subsidiary's proportion of ownership of the Partnership, changes in the management and control provisions of the Partnership agreement, and changes in the identity of the other partner.

J. Michael Shepherd
Senior Deputy Comptroller for
Corporate and Economic Programs

⁷ There we use the term "affiliate" in its general sense rather than the particular definition of 12 U.S.C. § 221a(b).

This is in response to your letter of August 12, 1986. You have raised two issues regarding *** (the Bank) and its legal lending limit under 12 U.S.C. § 84, in connection with the Bank's issuance of a standby letter of credit to support a particular bond transaction. Also, the Bank has entered into five Letter of Credit and Loan Participation Agreements with various banks, whereby these banks acquire an interest in the above-mentioned standby letter of credit. The first issue to be addressed concerns the lending limit exemption contained in 12 C.F.R. § 32.109(a) for loans fully secured by general obligations of a State or political subdivision thereof. The second issue you have raised involves the applicability of 12 C.F.R. § 32.107(a) to the five Letter of Credit and Loan Participation Agreements; specifically, you have asked whether back-up standby letters of credit operate as participations so as to remove a portion of the Bank's obligation under its standby letter of credit from the calculation of the Bank's lending limit to the account party. Both of these issues raise questions which have never been squarely addressed by this Office.

12 C.F.R. § 32.109

The relevant portions of 12 C.F.R. § 32.109(a) provide that, "A loan or extension of credit to a bank customer which is . . . fully secured by a 'general obligation' of any State or political subdivision thereof, within the meaning of 12 C.F.R. § 1.3(g), is not considered an obligation of the customer for purposes of 12 U.S.C. 84." That section further provides, in pertinent part, "The lending bank should obtain the opinion of competent counsel that the . . . collateral is a valid and enforceable obligation of the public body." Therefore, when deciding whether the exception contained in 12 C.F.R. § 32.109(a) is applicable to a particular transaction, there are two basic issues which must be addressed: (1) whether the loan is "fully secured" and (2) whether the collateral pledged as security for the extension of credit is a "general obligation of a State or any political subdivision thereof." In answering these two questions, it is important to understand the mechanics of the transaction, particularly in a situation where the OCC has not previously considered the specific issues presented.

Accordingly, as I understand the transaction, it is structured in the following manner. The Bank has issued a standby letter of credit for the account of the *** (Authority) and for the benefit of the holders of *** (Program Bonds), which are issued by the Authority. The proceeds from these bonds will be used to purchase bonds (General Improvement Bonds) issued by various governmental units (Governmental Units) located in the state of New Jersey. The General Improvement Bonds will, in turn, be pledged to secure the payment of principal and

interest on the Program Bonds, as well as all amounts owing to the Bank under its reimbursement agreement with the Authority. The General Improvement Bonds, after being issued to the Authority, will be endorsed to *** (the Trustee), as trustee under the issuance of the Program Bonds. Thus, the General Improvement Bonds will be in the possession of the Trustee. The Bank has also entered into a Reimbursement Agreement with the Authority, pursuant to which the Authority will "have an unqualified obligation to reimburse the [B]ank for payments made under the [standby] letter of credit." 12 C.F.R. § 7.7016.

1. Fully Secured

You have stated that the above-outlined arrangement will create a valid, enforceable and perfected security interest in the General Improvement Bonds in favor of the Bank and the holders of the Program Bonds. It appears, from the portion of the Bond Resolution you have quoted in your letter, that the Bank must share its collateral position in the General Improvement Bonds with the holders of the Program Bonds.¹ Notwithstanding this apparent shared-collateral position, I am assuming that the Bank will pay, under its letter of credit agreement, any principal and interest due on the Program Bonds and, therefore, stand in a first priority position with respect to its lien on the General Improvement Bonds. I am also assuming that you have correctly interpreted New Jersey's secured transactions law in your statement that the Trustee's possession of the General Improvement Bonds is sufficient to create a security interest in those bonds in favor of the Bank, thereby giving the Bank a secured position of higher priority than other creditors, even those creditors without notice of the Bank's security interest. Based on these assumptions, I agree with your conclusion that the Bank is "fully secured," as that term is used in § 32.109.

2. General Obligations of a State or Political Subdivision

The second question under § 32.109(a) can actually be broken down into two separate queries — (i) whether the issuer of the General Improvement Bonds is "a State

¹Section 601 of the Bond Resolution provides that, *inter alia*, the interest of the Authority in and to the General Improvement Bonds is "pledged for the payment of (a) the principal of and the interest on the Program Bonds in accordance with their terms and the provisions of the Resolution and (b) all amounts owing to the Bank . . . under the Reimbursement Agreement . . ." This provision was apparently necessitated by the bankruptcy case of *In re Twist Cap, Inc.*, 1 Bankr. 284 (Bankr. D. Fla. 1979), which prohibited a bank from honoring draws under standby letters of credit. The court found that it had jurisdiction over the letters of credit, because they were secured by property of the debtor. The court enjoined payment under the letters of credit, saying such payment would amount to an impermissible preference in favor of the unsecured creditor beneficiaries. *Id.* at 284. Even though this ruling has been widely discredited, the structure of the present transaction avoids the possibility of its recurrence by making the holders of the Program Bonds secured creditors at the inception of the transaction.

or any political subdivision thereof" and (ii) whether those bonds are "general obligations." The phrase "general obligation of any State or any political subdivision thereof" means an obligation supported by the full faith and credit of an obligor possessing general powers of taxation, including property taxation. 12 C.F.R. § 1.3(g). The phrase also includes an obligation payable from a special fund or by an obligor not possessing general powers of taxation when an obligor that does possess general powers of taxation including property taxation, has unconditionally promised to make payments into the fund or is otherwise available for the payment of amounts which (together with any other funds available for the purpose) will be sufficient to provide for all required payments in connection with the obligation. *Id.*

Thus, the issuer of the General Improvement Bonds must have general powers of taxation, including property taxation, in order to be considered a "State or any political subdivision thereof" by this Office. However, just because the obligor has general powers of taxation does not necessarily mean that the bonds will be accorded the favorable treatment given to general obligations; such treatment is reserved for issues which are backed, explicitly or implicitly, by a qualified issuer's general powers or taxation. Your letter quotes from the Bond Purchase Agreement — the document governing the transaction between the Authority and the Governmental Units — which says, in paragraph 6:

By virtue of the execution of this Bond Purchase Agreement, the Governmental Unit represents and warrants to, and agrees with, the Authority and the Bank (and it shall be a condition of the obligation of the Authority to purchase and to accept delivery of the Bonds that the Governmental Unit shall so represent and warrant as of the date of Closing) that:

(a) The Governmental Unit was duly created and organized as a political subdivision of the State of New Jersey (the "State") and that the Governmental Unit is authorized to issue the Bonds, to adopt the Local Proceedings, to perform its respective obligations thereunder and that it, or some other Governmental Unit providing security for the Bonds has the Authority to levy ad valorem property taxes on all taxable real property within the geographic area or jurisdiction of the Governmental Unit, to provide for the payments required under the Bonds, and the Bonds will constitute full faith and credit obligations of such Governmental Unit or the Governmental Unit providing security for such Bonds.

Therefore based on the above-quoted language from the Bond Purchase Agreement, it appears that the General Improvement Bonds — i.e., those issued by the Govern-

mental Units, purchased by the Authority and pledged to the Bank — satisfy both of the tests set forth in the definition of a "general obligation." First, the Authority can only purchase bonds which are issued by the State of New Jersey or a political subdivision thereof; and, secondly, the issuer, or some other Governmental Unit providing security for the obligations, will have general powers of taxation, including property taxation. Most importantly, however, the General Improvement Bonds will constitute full faith and credit obligations of the Governmental Unit issuing them or of the Governmental Unit providing security for such Bonds. Since the extension of credit to the Authority will be fully secured by general obligations, it meets the requirements of 12 C.F.R. § 32.109 and is exempt from the Bank's calculation of its lending limit with respect to loans to the Authority.

12 C.F.R. § 32.107

My analysis of the issues you have raised under 12 C.F.R. § 32.109 does, for the most part, render the question you have presented under § 32.107 moot. However, you suggest that there may be instances in which there will not be a sufficient amount of General Improvement Bonds pledged to the Bank so as to remedy any lending limit problems. It is in these instances that the Bank will have to rely on the § 32.107 exemption to the loans-to-one-borrower rules of 12 U.S.C. § 84. For that reason, I will next analyze the issues your transaction has created under the participations exemption of 12 C.F.R. § 32.107.

The issue under 12 C.F.R. § 32.107 which you have asked us to address presents a relatively novel concept. That is, whether the Bank can sell participations in the standby letter of credit it has issued for the account of the Authority, and thereby remove a portion of the "loan" from its lending limit, by having the participant banks issue standby letters of credit for the benefit of the Bank and for the account of the Authority. In general, it may be helpful to define the terms to be used in this portion of my response to your inquiry. "Back-up standby letter of credit" and "Back-up" both mean a letter of credit which is issued for the benefit of the issuer of a standby letter of credit and is used for the purpose of removing a portion of that standby letter of credit from the issuer's lending limit.² "Issuing Bank" means a bank which issues the original standby letter of credit — e.g., the Bank

²Back-up standby letters of credit are to be distinguished from back-to-back letters of credit. Back-to-back letters of credit consist of two commercial letters of credit, which are used to finance the sale of goods and are often issued by the same bank. The first letter of credit in a transaction using back-to-back letters of credit is issued for the benefit of the seller and for the account of the purchaser, the second letter of credit is issued in favor of the seller's supplier and for the account of the seller. See generally H. Harfield, *Bank Credits and Acceptances* 192-94 (5th ed. 1974).

in the instant situation. "Back-up Bank" means a bank which issues a back-up standby letter of credit. "Initial Draw" means a draw made on the Issuing Bank's standby letter of credit. "Back-up Draw" means a draw by the Issuing Bank on a Back-up standby letter of credit.

1. Back-up Standby Letters of Credit Generally

Section 32.107(a) provides that when a bank sells a participation in an extension of credit, that portion of the loan sold on a nonrecourse basis will not be applied to the bank's lending limits. A true participation is one which results in a pro rata sharing of the credit risk. This section is applicable to standby letters of credit, because 12 C.F.R. § 32.107(b) applies § 32.107(a) to "contractual commitments to advance funds," as that term is defined in 12 C.F.R. § 32.2(d) — a definition which specifically includes standby letters of credit. Since it is clear that standby letters of credit can be removed from a bank's lending limit by way of participations, and has been clear from the time standby letters of credit were made subject to a bank's lending limit,³ the initial question to be addressed is whether back-ups in general qualify as participations.⁴

In Interpretative Letter No. 322, December 31, 1984, by Rosemarie Oda, Senior Attorney, [1985 - 1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,492, the OCC ruled that standby letters of credit do not operate as "readily marketable collateral," under 12 C.F.R. § 32.4(c), so as to entitle the bank to an additional 10% lending limit. Furthermore, that letter is authority for the proposition that, when the lead bank has funded a loan, another bank's standby letter of credit does not qualify as a participation in that loan. Thus, it is clear that a bank cannot remove a portion of a funded loan from the calculation of its lending limit by means of standby letters of credit. Likewise, it is beyond dispute that a bank *can* remove a percentage of an unfunded "loan" — e.g., a standby letter of credit — from its books by selling an unfunded participation in that loan. However, it is unresolved at this time whether a portion of that same unfunded loan can be removed from a bank's lending limit with the use of a back-up standby letter of credit.⁵

³See 39 Fed. Reg. 28974 n. 2 (1974) (originally codified at 12 C.F.R. § 7.1160, but superseded by 48 Fed. Reg. 15852 (1983)).

⁴For an explanation as to why a back-up standby letter of credit may be preferred over a participation, see R. Ryan, Jr., *Letters of Credit Supporting Debt for Borrowed Money: the Standby as Backup*, 100 Banking L. J. 404, 418-19 (1983).

⁵In a July 2, 1976, letter, Deputy Chief Counsel John Shockey said that back-ups should be regarded as the equivalent of inter-bank participation agreements in standby letters of credit. In citing to Interpretative Ruling 7.1160, the forerunner to 12 C.F.R. §§ 32.2(d), 32.2(e) and 32.107, Mr. Shockey said, "[T]he lead bank is responsible only for its pro rata share . . . when calculating its exposure for purposes of 12 U.S.C. 84." I say that this issue has never been directly addressed, because the question to which Mr. Shockey was responding specifically

In my opinion, it is inappropriate to distinguish between participations and back-ups, when calculating the amount of credit the issuing bank has outstanding to the account party. The means by which the issuing bank is compensated by the participant/back-up bank in the event of default by the account party should be virtually indistinguishable, whether its obligation under the standby letter of credit is reduced by participations or back-up standby letters of credit. Under both instruments, the undertaking of the participant/back-up bank should arise upon the occurrence of the same condition, i.e., the default by the account party on its obligation to the beneficiary of the issuing bank's standby letter of credit. In which case, the issuing bank will notify the other banks — participants or back-ups — that the account party has defaulted and that there has been a draw on the issuing bank's standby letter of credit. What would appear to be the only difference between participations and back-up standby letters of credit is the name given to the notice received by the participant/back-up bank in the event of a default by the account party — the participant will receive a "notice of default" and the back-up bank will be presented with a draw upon its back-up standby letter of credit.⁶ In either situation, the participant or the back-up bank will be entitled to a pro rata share of all reimbursements the issuing bank obtains from the account party.

Even though the issuing bank remains liable to the beneficiary for the full amount of its standby letter of credit, the practical effect of the back-up is to shift a portion of the risk of the account party's default to the back-up bank. Therefore, the probable net exposure of the issuing bank to the beneficiary of its standby letter of credit is reduced by the amount it is entitled to receive as beneficiary of a back-up standby letter of credit. It follows that the amount the issuing bank must count as a "loan" to the account party should be reduced to reflect this sharing of the risk. From the point of view of the back-up bank, its standby letter of credit (which is issued for the benefit of the issuing bank) will be treated as an extension of credit to the account party (just as if it had purchased a participation in the issuing bank's standby letter of credit), regardless of whether the back-up is viewed as reducing the amount of credit the issuing bank has outstanding to the account party. In other words, if a back-up standby letter of credit is not the same as a participation, the full amount of the issuing bank's standby letter of credit will be considered a loan to the account party, as well as the amount of any back-up the issuing bank may have obtained. Thus, in general, a back-up standby letter of credit operates like a participation agreement in removing a portion of a

contemplated "participations" in a standby letter of credit. However Mr. Shockey went beyond the scope of the immediate facts to speak to the hypothetical situation in which the participating bank issues its own standby letter of credit for the benefit of the lead bank. That letter is unpublished, but a copy is attached hereto.

⁶But see *supra* note 4

standby letter of credit from the issuing bank's lending limit.

In order to qualify as a pro rata sharing of the risk, a back-up standby letter of credit must be in place at or before the time the issuing bank's standby letter of credit becomes effective. Even though a true participation may exist at the inception of the transaction, i.e., before an initial draw is ever made on the issuing bank's standby letter of credit, one must look at how the back-up standby letter of credit is to be funded in the event of an initial draw, to determine whether the back-up bank is actually sharing part of the risk that the account party will default on its obligation to the beneficiary. In other words, an unfunded "loan" can be backed by an unfunded "loan," but a funded loan cannot be so backed; thus, once the issuing bank's standby letter of credit becomes funded, the back-up bank's back-up standby letter of credit must also be funded. Generally speaking, a normal participation must be funded at or about the time the lead bank's loan is funded. See OCC No-objection Letter No. 86-16, October 27, 1986, by James M. Kane, District Counsel, Fed. Banking L. Rep. (CCH) ¶ 84,024. However, since a bank ordinarily has three days in which to determine whether it will honor a draft under a letter of credit,⁷ it is reasonable to extend the time in which a back-up bank must fund its pro rata share of any initial draw; therefore, back-up draws must be funded within twenty-four hours of the presentation of an initial draw by the beneficiary of the issuing bank's standby letter of credit.

2. The Specific Transaction

In determining whether a given transaction constitutes a valid loan participation for lending limit purposes, the key issue is whether the transaction effectively shifts a share of the risk of the borrower/account party's default from the issuing bank to the participant/back-up bank. The "participation" portion of the present transaction is complex and, in order to properly address the issues presented, must be clearly understood. Thus, the following is my understanding of the structure of the transaction.

As previously mentioned, the Bank has entered into five Letter of Credit and Loan Participation Agreements with various banks ("Back-up Banks"), four of which are affiliates of the Bank.⁸ There are seven types of draws that can

be made under the Bank's Letter of Credit. Each such initial draw creates a right in the Bank to make a back-up draw on all five of the back-up standby letters of credit. "A," "C" and "G" drawings are for the purpose of paying principal on the Program Bonds. If one of these drawings should occur, each of the Back-up Banks is required to transfer its pro rata share, in immediately available funds, to the Bank on the day of the draw. A draw to pay interest on the Program Bonds may be a "D," "E" or "F" drawing. When such a draw takes place, each Back-up Bank will be notified of the amount that remains unreimbursed by the close of business on the day of the drawing; the Back-up Banks must then transfer their pro rata shares, in immediately available funds, on the next business day. A "B" drawing is used to pay a portion of the purchase price of the Program Bonds, in the event one of the Bonds is "put" to the remarketing agent and cannot be resold. The remarketing feature of the transaction allows a holder of a Program Bond to sell his bond to the Authority's agent who will then attempt to mark the bond to market and resell it. If the bond cannot be successfully remarketed, the remarketing agent has the right to draw on the Bank's standby letter of credit (a "B" draw) in an amount equal to the price it paid the bondholder for the bond. Thus, in addition to the Trustee for the holders of the Program Bonds, the remarketing agent is a beneficiary of the Bank's standby letter of credit. The obligation of the affiliate Back-up Banks, in the event a "B" drawing is made, is to transfer immediately available funds to cover its portion on the day of the drawing. The reason "B" drawings are not considered in the same category as "A," "C" and "G" drawings is because the non-affiliate Back-up Banks does not have to fund its obligation under the Bank's back-up draw until sixty days after a "B" drawing has occurred. Nonetheless, all of the back-up standby letters of credit are subject to a back-up draw on occasion of any one of the seven initial draws that might occur under the Bank's standby letter of credit. This is the basic framework from which I will address the questions that your transaction presents under 12 C.F.R. § 32.107.

At the inception of the transaction under consideration, the Bank had an unfunded "loan" that was backed by five unfunded "loans." If the other requirements for a true pro rata sharing of the risk are present, the five back-ups will have the effect of participations and reduce the amount of credit the Bank has outstanding to the Authority. With the exception of the non-affiliate Back-up Bank's obligation in the event of a "B" draw, all of the draws on the Bank's standby letter of credit have the potential of triggering payment by the Back-up Banks within twenty-four hours of the initial draw.⁹ Because the non-affiliate

⁷See OCC § 5.112(1)(a).

⁸Anytime affiliates are involved in a transaction, one must consider the applicability of 12 U.S.C. § 371c to that transaction. However, it is my opinion that the implications under 12 U.S.C. § 371c have little, if any, bearing on the issue at hand, i.e., removing a portion of the Bank's extension of credit to the Authority from the calculation of the Bank's lending limit. But see *infra* note 9 and accompanying text. Furthermore, since the transactions are bank-to-bank, § 23B of the Federal Reserve Act, which applies

⁹As long as each affiliate Back-up Bank funds its pro rata share of an initial draw within twenty-four hours of such draw, it would not appear

Back-up Bank's back-up standby letter of credit does not provide for immediate funding for "B" draws, none of its back-up can be used as a means of reducing the amount of credit the Bank has outstanding to the Authority. Even though a "B" draw is probably the least likely one of the seven to occur, it is virtually impossible to determine the exact amount of risk that the non-affiliate Back-up Bank has removed from the Bank. With respect to the remaining Back-up Banks, their back-up standby letters of credit operate to fully remove each Back-up Bank's pro rata share from the Bank's lending limit. Therefore, as long as the affiliated Back-up Banks have issued back-up standby letters of credit in amounts sufficient to reduce the Bank's extensions of credit to the Authority below the limit set by 12 U.S.C. § 84, this transaction does not appear to create a lending limit violation.

Conclusion

In the final analysis, it is my opinion that all of the elements required by 12 C.F.R. §§ 32.109(a) and 1.3(g) are contained in the transaction as you have presented it and, therefore, that to the extent Bank is "fully secured" its standby letter of credit issued for the account of the Authority will not be considered an obligation of that account party for purposes of 12 U.S.C. § 84. Furthermore, I am of the opinion that the back-up standby letters of credit issued by the affiliates of the Bank operate as the equivalent of participations under 12 C.F.R. § 32.107(a) and, as such, remove a portion of the Bank's obligation to the beneficiary from the calculation of the Bank's lending limit with respect to the Authority. However, the portion of the transaction which gives the non-affiliate Back-up Bank sixty days in which to make a payment under its back-up standby letter of credit does not qualify as a valid participation. Therefore, the structure of the transaction qualifies for two separate exceptions to the lending limit provisions of 12 U.S.C. § 84; that is, even when the Bank is not fully secured by general obligations, the back-up standby letters of credit serve to remedy any potential lending limit problems, up to the amount of the back-ups issued by the affiliate Back-up Banks. I note that these conclusions are closely based on your recitation of the facts, and if there is a change in these facts the opinion issued in this letter could change.

that the Bank has made an "extension of credit" to the affiliate within the meaning of 12 U.S.C. § 371c. However, if a back-up draw on an affiliate's back-up standby letter of credit is not funded within twenty-four hours, an extension of credit subject to the limitation of § 371c would arise, in addition to a potential lending limit violation. This is because the Bank will be paying out its own funds in anticipation of reimbursement from draws on the back-up standby letters of credit provided by the affiliate banks. However, as long as the affiliates are "banks," as that term is defined in § 371c(b)(5), and the holding company controls at least 80% of each affiliate's voting stock, only two provisions of § 371c apply: the prohibition against purchasing low-quality assets (12 U.S.C. § 371c(a)(3)) and the safe and sound banking practices limitation (12 U.S.C. § 371c(d)(1)(C)).

I trust this has been responsive to your inquiry and regret the delay in response. I have only addressed issues relating to lending limits and do not express any opinion on other issues which may be raised by the transaction, such as whether the rights acquired by the Bank in the bonds following a "B" draw are consistent with the restrictions of the Glass-Steagall Act. If you wish to discuss this matter further, please feel free to call Sanford Brown, Attorney, Legal Advisory Services Division at (202) 447-1880

Peter Liebesman
Assistant Director
Legal Advisory Services Division

* * *

413—December 30, 1987

William H. Rheiner, Esq.
Ballard, Spahr, Andrews & Ingersoll
30 South 17th Street — 20th Floor
Philadelphia, PA 19103

Re: Provident National Bank, Philadelphia, Pennsylvania
(Bank)

Dear Mr. Rheiner:

This is in response to your May 5, 1987 and subsequent letters regarding the Bank's proposal to establish a collective investment trust (Trust) for the collective investment of individual retirement account (IRA) trust assets exempt from taxation under Section 408 of the Internal Revenue Code of 1986, as amended (IRC). The collective investment trust will also include single or commingled pension or profit-sharing trusts maintained in conformity with Section 401(a) and exempt from taxation under Section 501(a) of the IRC.

The Bank's plan is identical in all material respects, with two exceptions noted below, to the collective investment trusts approved by this Office in the applications of Chase Manhattan Bank, N.A. (November 14, 1986) (Chase Manhattan Approval) and First Fidelity Bank, N.A. (March 19, 1987) (First Fidelity Approval). Furthermore, but for the addition of single or commingled pension or profit-sharing trust funds, the Bank's plan is similar in all material respects to other collective IRA trusts previously approved by this Office. See *Decision of the Comptroller of the Currency on the Application by Citibank, N.A., Pursuant to 12 C.F.R. § 9.18(c)(5) to Establish Common Trust Funds for the Collective Investment of Individual Retirement Account Trusts Exempt from Taxation under Section 408 of the Internal Revenue Code of 1954* (October 21, 1982) (Citibank Decision); *Decision of the Office of the Comptroller of the Currency on the Application by Wells Fargo Bank, N.A. to Establish a Common Trust Fund for the*

Collective Investment of Individual Retirement Account Trust Assets Exempt from Taxation under Section 408(a) of the Internal Revenue Code of 1954, as Amended (January 27, 1984) (Wells Fargo Decision); and *Decision of the Comptroller of the Currency on the Application of Connecticut Bank and Trust Company, N.A., to Establish a Common Trust Fund for the Collective Investment of Individual Retirement Account Trust Assets Exempt from Taxation under Section 408(a) of the Internal Revenue Code of 1954, as Amended* (February 7, 1985) (Connecticut Bank and Trust Decision). These decisions have been upheld in opinions by the Courts of Appeals for the DC, Ninth and Second Circuits, respectively (collectively, the IRA Cases).¹ This Office is of the view that the activities described in your letters and attachments thereto constitute lawful bank fiduciary activities which comply with the requirements of 12 U.S.C. Part 9 and are not inconsistent with the requirements for the Glass-Steagall Act, specifically 12 U.S.C. §§ 24 (Seventh), 377, 378, and 78.

Our conclusion regarding the permissibility of the fiduciary services proposed to be offered by the Bank is supported by the nature of the relationships between the Bank as trustee of the Trust, and the Bank as trustee of the individual trusts participating in the Trust. Under Pennsylvania law, a valid trust is created when the following elements exist: (1) sufficient words to create the relationship; (2) a definite subject; and (3) a certain and ascertained object. See *Lawrence v. Godfrey*, 296 Pa. 474, 146 A. 107 (1929); *Bair v. Snyder County State Bank*, 314 Pa. 85, 171 A. 274 (1934). The Bank has provided its opinion of counsel that the Trust agreement and participating trust agreements contain these elements. Because the Trust agreement and participating trust agreements contain the elements required under Pennsylvania law, we are satisfied as to the validity of the Trust and the participating trusts. Accordingly, under the terms of 12 U.S.C. § 92a, the Bank is empowered to offer the fiduciary services represented by the Trust.

This Office has carefully considered the features of the Trust and the participating trusts. In two respects, the Trust raises questions concerning its conformance to the requirements of 12 C.F.R. § 9.18(b). The pertinent provisions require the outside auditors to be responsible solely to the Bank's board of directors and require the Bank to exercise exclusive management over its collective investment funds. See 12 C.F.R. §§ 9.18(b)(5)(i), 9.18(b)(12). Both provisions may raise questions with respect to the Bank's

Trust program which arise out of the Bank's decision to register the Trust with the Securities and Exchange Commission (SEC) as an "investment company" under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 et seq. However, the decisions of this Office which were upheld in the above cited IRA Cases addressed these same questions and concluded that the respective banks were permitted to operate their trust plans in compliance with 12 C.F.R. § 9.18.

In the plan proposed by the Bank (and the plans at issue in the Chase Manhattan Approval and the First Fidelity Approval), the Bank would commingle in its collective investment trust IRA trust funds with single or commingled pension or profit-sharing trusts (Section 401 trust funds). The collective investment of Section 401 trust funds is a traditional banking service which banks have long performed. The exemption from taxation which IRC Sections 401(a) and 501(a) provide is available only to "qualified trusts" and, accordingly, contemplates the existence of a true fiduciary purpose of all such trusts. Thus, the collective investment of Section 401 trust funds involves no less a true fiduciary purpose than the collective investment of IRA trust assets. This additional activity will not jeopardize the exemption from federal taxation separately accorded each type of trust fund. See IRC Section 408(e)(6) and Rev. Rul. 66-297. The Trust interests will be registered with the SEC under the Securities Act of 1933 and the Investment Company Act of 1940, regardless of those exemptions from registration which normally are available to collective investment funds for the collective investment of Section 401 trust funds.

In addition, it is noted that the proposed Trust differs in two further respects from those approved in the above-cited cases. First, the Bank proposes to permit the participation in the Trust by trusts for which affiliates of the Bank act as trustee. Second, the Bank, as trustee, proposes to charge the Trust an ongoing fee that for certain participating trusts may not be consistent with the fee requirements of 12 C.F.R. § 9.18(b)(12).

With respect to the first difference, it is our view that such participation by affiliate banks is both consistent with the requirements of 12 C.F.R. Part 9 and permissible under the Glass-Steagall Act. Various trust precedents and opinions of the Office have discussed certain requirements of Part 9 which are applicable to this proposal. Opinion 9.6700 provides, for example, that if state law permits the establishment of common trust funds for affiliated banks, authorized accounts may participate in the collective funds maintained by those affiliates. You have represented that the Bank will obtain an opinion of counsel affirming the permissibility of the proposal in all states in which the Bank has affiliates. Opinion 9.6700 further requires that all authorized accounts be affiliated within the meaning of IRC section 1504, 26 U.S.C. § 1504. Since the Declara-

¹*Investment Company Institute v. Conover*, 790 F.2d 925 (DC Cir. 1986); *Investment Company Institute v. Clarke*, 793 F.2d 220 (9th Cir. 1986); *Investment Company Institute v. Clarke*, 789 F.2d 175 (2d Cir. 1986) (per curiam). In December 1986, the United States Supreme Court decided *Clarke* and all three cases. See *Investment Company Institute v. Clarke*, 107 S. Ct. 421-422 (1986).

tion of Trust permits participation only by banks which are affiliates within the meaning of § 1504, the Bank meets this requirement. See also Opinion 9.6705 regarding appropriate authorization for use of the Trust.

We also note that this Office's regulations promulgated at 12 C.F.R. § 9.1(k) define the term "bank" for Part 9 purposes as including members of the same affiliated group with respect to any fund established pursuant to § 9.18. As stated above, all banks in the proposed plan will be affiliated within the meaning of I.R.C. § 1504. Inasmuch as the provisions of the Declaration of Trust comply with the relevant trust precedents and opinions of the Office, the participation in the Trust by trusts for which the affiliate banks act as trustee is permissible under 12 C.F.R. Part 9.

The participation in the Trust by trusts for which the affiliate banks act as trustee also is permissible under the Glass-Steagall Act. The Supreme Court's decision in *ICI v. Camp*, 401 U.S. 617 (1971) (Camp) and the recent judicial decisions approving collective IRA funds support this position. See IRA Cases, *supra*, p. 2. In *Camp*, the Supreme Court invalidated an Office regulation permitting a national bank to operate a collective fund for managed agency accounts. In reaching this decision, the Court contrasted this activity with the permissible and well-established pooling and collective investment of trust assets. The Court specifically noted that "[f]or at least a generation . . . there has been no doubt that a national bank can, consistently with the banking laws, commingle trust funds," and that "[n]o provision of the banking law suggests that it is improper for national banks to pool trusts assets . . ." *Camp*, 401 U.S. at 624-25. Since deciding *Camp*, the Supreme Court has reaffirmed that nothing in the Glass-Steagall Act prohibits banks from commingling and investing the trust funds of customers. See *Board of Governors v. Investment Company Institute*, 450 U.S. 46, 55 (1981). Additionally, the collective IRA Cases, cited above, stand for the proposition that assets can be managed in a bank's collective investment fund so long as those assets are held for a true fiduciary purpose. See also IRC § 408(a)(5). We believe the Bank's proposal meets this legal standard.

The instant proposal, like those at issue in the IRA Cases and in the Chase Manhattan and First Fidelity Approvals, involves the commingling of trust assets for a true fiduciary purpose and not for general investment. First, as in those cases, the fact that assets are required to be held in trust renders applicable all the restrictions and protections imposed by local trust law. These restrictions obligate the Bank, as trustee, to administer the trust for the exclusive benefit of the Trust participants and prohibit trustee self-dealing, undisclosed adverse interests, transactions involving undue influence on the part of a trustee, and fraudulent trustee conduct. See *In re Comerford's Estate*,

388 Pa. 278, 1309 A. 2d 458 (1957), Restatement (Second) of Trusts §§ 169-185 (1959). Second, as in the IRA Cases, the Bank, as trustee, is subject to relevant provisions of the IRC and regulations promulgated thereunder, governing, *inter alia*, prohibited transactions by disqualified persons (which include fiduciaries. See IRC § 4975). Similar restrictions are imposed by this Office's regulations. See 12 C.F.R. §§ 9.12, 9.18(b)(8). Third, as in the IRA Cases, the fiduciary nature of the Trust is further demonstrated by the purpose for which the individual participant establishes a trust, *i.e.*, the preservation and growth of assets in anticipation of retirement, and by the restrictions imposed by ERISA and the IRC. These restrictions, while not identical in their treatment of IRAs and other types of pension plans, nevertheless ensure that neither section 401 nor section 408 funds can be used for general investment purposes. For example, for both types of funds, these restrictions prohibit investment of the Trust assets in a manner inconsistent with the retirement purpose. IRC § 408(m). Any distribution of Trust assets before the settlor reaches age 59 1/2 triggers a severe tax penalty. IRC § 72(t). Interests in the Trust, unlike other types of investments, are not freely transferable. IRC §§ 408(b)(i), 401(a)(13). They cannot be used as security for a loan. IRC §§ 408(e)(4), 4975. This statutory framework supports the conclusion that the Trust represents the offering of bona fide fiduciary services not prohibited by the Glass-Steagall Act.

The participation by the Bank's affiliates merely enables the Bank and its affiliates to offer the same lawful service to other fiduciary customers. Those restrictions imposed by local trust law and by ERISA, which were applicable to previous decisions of this Office involving collective investment trusts, are equally applicable to the Bank's proposal to permit the participation in the Trust by trusts for which Bank affiliates act as trustee. A participant in a trust account of an affiliate bank will be able to make use of the Trust under the provisions of the proposed plan only if the affiliate's account is a "Qualified Trust." Under the Declaration of Trust, a "Qualified Trust" must be maintained in conformity with Internal Revenue Code sections 401 or 408 and, thus, subject to the restrictions found therein and discussed above. Section 6.3 of the Declaration of Trust provides that if it should be determined that any participating trust is no longer a "Qualified Trust," the Trustee (*i.e.*, the Bank) shall withdraw from the Trust all units owned by such participating trust. This provision ensures that only IRA and employee benefit fiduciary accounts are maintained in the Trust. In addition, as stated above, ERISA imposes a set of fiduciary duties and obligations which ensure that the Trust is established as a proper banking and fiduciary service, and cannot serve simply as a vehicle for investment, as was determined to be the case in *Camp*. Therefore, the existence of a trustee relationship between the affiliate banks and their customers, coupled with the strict restrictions imposed by

ERISA is sufficient to establish the fiduciary nature of the Bank's plan and to ensure that the hazards and potential abuses against which Congress sought to legislate in the Glass-Steagall Act do not exist in the instant application.

For the reasons set forth in the above-cited decisions, which are equally applicable to the instant proposal, this Office grants permission pursuant to 12 C.F.R. § 9.18(c)(5) for the Bank to operate the proposed Trust. As with the previous decisions, the Office reserves the right to rescind this approval should the supervisory committee of the Trust interfere with or terminate the management duties of the Bank as trustee and investment advisor to the Trust.

As stated above, there is a further issue raised by the Bank's plan to charge the Trust an ongoing fee of a percentage of net assets on an annualized basis. In the case of participating trusts, and in particular insofar as concerns funds maintained in conformity with Section 401 of the IRC, this fee may not be consistent with 12 C.F.R. § 9.18(b)(12), which states:

The bank may charge a fee for the management of the collective investment fund provided that the fractional part of such fee proportionate to the interest of each participant shall not, when added to any other compensations charged by a bank to a participant, exceed the total amount of compensations which would have been charged to said participant if no assets of said participant had been invested in participation in the fund.

You have represented that this provision does not present a problem for IRA funds exempt from taxation under Section 408 of the IRC, inasmuch as the proportionate fees charged to participating IRA trusts would be lower than would be charged to an IRA trust participant seeking to place his assets in an individually-managed portfolio of securities approximating the investment strategies incorporated into the Trust agreement. However, you have noted the possibility that participants in certain pension or profit-sharing trusts maintained in conformity with Section 401 of the IRC might be able to obtain management services for an amount less than that which the Bank proposes to charge, a situation which may be deemed to present a potential violation of the above regulation.

With respect to the proposed fee, the Bank as Trustee has made the following representations:

1. The management fee will be charged for the provision of services which are usually and customarily rendered by a trustee to a collective fund.
2. Except insofar as discussed herein, the fees and expenses to be charged to the common trust fund will be in accordance with the rules and regulations of the

OCC pertaining to collective investment funds and the interpretations issued thereunder.

3. All employee benefit accounts participating in the Trust will specifically incorporate by reference the terms of the Trust.
4. The governing documents of all participating accounts will specifically authorize the investment in the Trust and Trustee's fee set forth above.
5. Only accounts directed by the participant will participate in the Trust.
6. The fee will be disclosed as a separate line item on participating account statements and in the annual financial statements for the Trust.
7. All material terms affecting the rights of the participants will be accurately and fully disclosed in the Declaration of Trust.

Based upon the above representations, which will ensure, among other things, that Trust participants will be able to make an informed decision on the costs of participation in the Trust, and to the extent that the Bank's proposed fee arrangements do not comport with the requirements of 12 C.F.R. § 9.18(b)(12) pertaining to fee charges, the Office will grant a waiver of those restrictions, pursuant to 12 C.F.R. § 9.18(c)(5), to permit the Trustee to charge the above-described fee.

Finally, approval of the Bank's proposal is not precluded by the recently enacted Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 100 Stat. 552. Section 201(b) of the Act imposes a temporary moratorium on approvals of certain securities activities of banking organizations. The Bank's proposal is not covered by the moratorium because it does not involve a securities activity. The establishment of a collective investment trust for IRA accounts has been determined by this Office and courts in three federal circuits to constitute a "fiduciary activity" which banks may lawfully engage in under the national banking laws. See IRA Cases, *supra*. As discussed above, the Bank's proposal to accept affiliate bank IRA customer assets into the Trust does not alter in any respect the fiduciary nature of these trusts, and therefore, our review of this proposal is not precluded by the moratorium. Moreover, even if the Bank's proposal did involve a securities activity, it would not be covered by the moratorium. Under Section 201(b)(2)(B), a federal banking agency may not authorize a bank to engage "in any securities activity not legally authorized in writing prior to March 5, 1987;" the moratorium, however, does not preclude approval of activities lawfully engaged in prior to March 5, 1987. The Bank's proposal is not covered by the moratorium because the activity in question has been

lawfully engaged in, with the repeated approval of this Office, prior to March 5, 1987. See Chase Manhattan Approval and approvals cited in the IRA Cases, *supra*.

As our position is based on the specific facts and representations made in your letters and attachments thereto, you should be aware that any alteration in the terms of the Bank's proposal might require another interpretation. Further, this letter only expresses this Office's position based on current statutes and regulations and is subject to modification as future legislative, judicial or regulatory developments warrant.

Robert J. Herrmann
Senior Deputy Comptroller for Bank Supervision

* * *

414—February 11, 1988

Mr. Jeffrey S. Lillien
Senior Attorney
General Counsel's Office
The First National Bank of Chicago
One First National Plaza
Chicago, IL 60670

Dear Mr. Lillien:

This responds to your February 9, 1987, notification that First Chicago Futures, Inc. (FCFI), an operating subsidiary of the First National Bank of Chicago (the Bank), intends to buy and sell foreign currency in the spot and forward markets and to buy and sell over-the-counter foreign currency options. FCFI expects that this activity will be used both to hedge FCFI's foreign currency exposures resulting from FCFI's activities as a market maker in exchange-traded currency options for arbitrage purposes. The counterparty to the transactions will initially be the Bank; later transactions are expected to include other parties. The activities will be conducted in Chicago, Illinois, or through FCFI's or the Bank's locations outside the United States.

The Bank contends, correctly, that the proposed transactions in the spot market are the purchase and sale of foreign currencies, activities authorized by 12 U.S.C. § 24 (Seventh), which provides that a national bank may engage in "buying and selling exchange, coin, and bullion . . .," and that the use of forward and options contracts for hedging purposes was approved by the OCC in Banking Circular No. 79 (1983) and OCC Letter No. 260 (June 27, 1983), *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,424.

The Bank also correctly notes that the use of futures contracts for arbitrage purposes was allowed by the OCC

in a pair of OCC letters dated August 8, 1986. Letter of Charles M. Horn, Assistant Director, Securities & Corporate Practices (Aug. 8, 1986); letter of Michael Patriarca, Deputy Comptroller for Multinational Banking (Aug. 8, 1986). The bank in that case had been an active and substantial participant in the cash markets as an underwriter and dealer in bank-eligible securities and had sought to participate in arbitrage activities. The bank there contended that arbitrage activity would provide a source of information that would enhance its ability to predict market movements and to establish and maintain optimal trading positions in its cash market activities. This Office approved the proposed activities, subject to the following conditions:

(1) Nonhedging uses of such contracts would only be undertaken by dealer units;

(2) nonhedging activities would be limited to contracts on instruments in which the bank is authorized to and does in fact deal;

(3) futures contract positions used for nonhedging purposes would be limited to amounts that do not exceed trade date position limits on related cash instruments;

(4) aggregate bankwide positions in any futures contract would be limited to a reasonable percentage of the total "open interest" in a contract month, consistent with safety and soundness considerations;

(5) the board of directors would approve written policies that specifically address nonhedging strategies; and

(6) controls, limits, and accounting procedures discussed in Banking Circular No. 79 would be established, with appropriate tests to evaluate the program on an ongoing basis.

From the representations in your letter and from the substance of prior OCC approvals with respect to FCFI it appears that the situation of FCFI, while it contemplates the use of options and forward contracts rather than futures contracts and deals with foreign currency rather than bank-eligible securities, is comparable to that forming the basis for the August 8, 1986, letters and that the proposed activities are therefore within the scope of prior OCC approvals.

Finally, we observe that the moratorium enacted on August 10, 1987, as § 201 of the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 201, 100 Stat 552, provides in relevant part

(a) federal banking agency may not authorize or allow by action, inaction, or otherwise any insured bank or subsidiary . . . thereof to engage in the United States to any extent whatever —

* * *

(B) in any securities activity not legally authorized in writing prior to March 5, 1987, or

(C) in the operation of a nondealer marketplace in options.

Subparagraph (B) shall not affect (i) activities in which . . . any insured bank or subsidiary . . . thereof acts only as an agent; (ii) activities which had been lawfully engaged in prior to March 5, 1987 . . .

Applying the facts of your submission to the language of the Act, we conclude that the moratorium does not affect the bank's proposed activities. Foreign currency, forward contracts for foreign currency and over-the-counter foreign currency options are not "securities" under any federal law. A foreign exchange option that is traded on a securities exchange is, for purposes of dividing jurisdiction between the Securities and Exchange Commission and the Commodity Futures Trading Commission, defined as a "security" under securities law, see 15 U.S.C. 77b(1). This need not concern us here, however, because (1) the proposal deals only with over-the-counter foreign exchange options, not those traded on an exchange; (2) this definition was not intended to affect banks' options activities;* and (3), in any case, this Office issued written approval to FCFI, on November 7, 1986, to act as a market maker, buying and selling exchange-traded foreign exchange options for its own account and for the accounts of others. Note, too, that this Office approved, prior to March 5, 1987, the use of options and forward contracts for hedging and the use of futures for arbitrage purposes. See Banking Circular No. 79; OCC Letter No. 260, *supra*; two OCC letters of August 8, 1986, *supra*. Finally, the proposed options activities do not involve operating a nondealer marketplace in options.

*Senator D'Amato made clear on the Senate floor that including exchange-traded foreign exchange options in the 1982 amendment to the definition of "securities" under 15 U.S.C. § 77b(1) was not to affect banks' options activities, stating as follows

"It has been called to my attention that, by including 'option' within the definition of 'security' in certain securities laws, an inference might be drawn that banks could not deal in such options. I would therefore like to clarify that this change is not intended to affect a bank's activities under the Glass-Steagall Act and that, if a bank is permitted to purchase and sell the underlying security — such as a U.S. government security — then it would also be permitted to purchase and sell options on such securities. (128 Cong. Rec. S13122-13 (daily ed. Oct. 1, 1982).)"

Accordingly, this Office would not object to the proposed expansion of FCFI's activities, subject to the supervisory restrictions listed in the August 8, 1986, letter from Michael Patriarca, Deputy Comptroller for Multinational Banking, cited above. This position is based upon the representations made in your submission of February 9, 1987, and subsequent conversations with attorney Bruce Oliver of this Office. Different facts or circumstances may affect the position taken. In addition, our view is based on current law and may be subject to revision as future developments warrant. We further reserve the right to modify the views expressed herein or provide additional comments in the future.

J. Michael Shepherd
Senior Deputy Comptroller
for Corporate and Economic Programs

* * *

415—February 12, 1988

Bruce Moland
Vice President and
Assistant General Counsel
Norwest Corporation
1200 Peavey Building
Minneapolis, Minnesota 55479

Dear Mr. Moland:

This is in response to your letter of January 28, 1987, to Mr. John Rogers, Director of Analysis, Midwestern District. Your letter provided notification, as required by our regulations at 12 C.F.R. § 5.34, of an intent to change the status of Norwest Investment Services, Inc. (the Subsidiary) from that of a bank service corporation to an operating subsidiary of Norwest Bank Minneapolis, N.A. (the Bank). The District Office referred this notification here for consideration.

It is our opinion that the status of the Subsidiary may be changed from that of a bank service corporation to an operating subsidiary of the Bank subject to certain limitations. The reasons are outlined in the following discussion.

The Subsidiary is a government and municipal securities dealer, and is registered as a broker-dealer with the National Association of Securities Dealers.

The following represents our understanding of the specific activities proposed for the operating subsidiary. It desires to engage in all securities-related activities that have been or will be authorized as permissible securities activities by the Office of the Comptroller of the Currency. This includes but is not limited to government securities and

municipal securities (general obligation) dealer activities, including GNMA's and FNMA; and money market instrument dealer activities including but not limited to certificates of deposits, bankers acceptances and repurchase agreements. In addition, NISI would engage in general securities brokerage activities including but not limited to unit investment trust and mutual fund activities including the provision of advice in connection with such activities (See Interpretive Letter Number 386 dated June 19, 1987, responding to NCNB of North Carolina); sale of annuities as agent; municipal lease activities as agent; and commercial paper and Euro time deposit activities as agent and private placement of various types of securities.

In your notice, you request to engage in "all securities-related activities that have been or will be authorized by the Office of the Comptroller of the Currency." Unique and changing economic circumstances and supervisory concerns occasionally lead the OCC to impose conditions or deny applications for authority to engage in certain new activities. Accordingly, we cannot grant such a sweeping request as you have made for authority to engage in all securities activities that we may authorize in the future. With respect to the specific activities listed above, we believe that the moratorium is not applicable.

In August 1987, legislation was passed affecting banks and their securities activities. Section 201(b) of the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 100 Stat. 552, provides in relevant part:

(2) A Federal banking agency may not authorize or allow by action, inaction, or otherwise . . . any insured bank or subsidiary or affiliate thereof to engage in the United States to any extent whatever

—

. . . .
(B) in any securities activity not legally authorized in writing prior to March 5, 1987 . . .

However, the statutory moratorium does not apply to activities that were lawfully engaged in prior to March 5, 1987.

All of your proposed specific activities were either authorized in writing for national banks by this Office or lawfully engaged in by national banks prior to March 5, 1987, and thus are not subject to the moratorium. Activities that are relevant to your notification, together with legal authority for them, may be most conveniently summarized as follows:

1. Dealing in U.S. government and municipal general obligation securities — expressly authorized by 12 U.S.C. § 24 (Seventh).

2. Dealing in the secondary market in certificates of deposit — traditional activity, see Letter of William B. Camp, Comptroller of the Currency (December 29, 1971), *quoted in* Interpretive Letter No. 385, [Current] Fed. Banking L. Rep. (CCH) ¶ 85,609 at 77,929-30 (June 19, 1987).

3. Dealing in bankers' acceptances — traditional activity, see Interpretive Letter No. 268, [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,432 (August 4, 1983).

4. Selling participations in bankers' acceptances — Interpretive Letter No. 272, [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,436 (August 4, 1983).

5. Repurchase agreements involving loans, short-term promissory notes, certificates of deposit, bankers' acceptances — traditional activities, see OCC Staff Letter, [1978-1979 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,020 (no date); Interpretive Letter No. 109, *id.* ¶ 85,184 (July 12, 1979).

6. Repurchase agreements involving U.S. government securities — traditional activity, see OCC Banking Circular No. 157, *reprinted in* 5 Fed. Banking L. Rep. (CCH) ¶ 60,798 at 38,852 (May 13, 1981).

7. Purchase and sale, on an agency basis, of shares in mutual funds and units in unit investment trusts — Interpretive Letter No. 363, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,533 (May 23, 1986).

8. Furnishing investment advice and agency brokerage service in the same operating subsidiary — Interpretive Letter No. 360, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,530 [April 16, 1986] (institutional investors); Interpretive Letter No. 370, *id.* ¶ 85,540 (April 16, 1986) (retail customers).

9. Sales of variable-rate annuity contracts — Interpretive Letter No. 331, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,501 (April 4, 1985).

10. Agency placement of municipal equipment leases and installment purchase contracts, or participations therein — Interpretive Letter No. 250, [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,414 (October 6, 1982).

11. Agency placement of commercial paper — Interpretive Letter No. 329, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,499 (March 4, 1985).

12. Buying and selling Eurodollar time deposits — authorized by 12 U.S.C. § 24 (Seventh), see Interpretive Letter No. 384 [Current] Fed. Banking L. Rep. (CCH) ¶ 85,608 (May 19, 1987)

13. Private placement of securities — Interpretive Letter No. 32 [1978-1979 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,107 (December 9, 1977)

The Subsidiary will have a number of offices at locations which are not branches of the Bank. If the Subsidiary will make margin loans to customers, such loans should be limited to Bank headquarters or branch locations. *Securities Industry Association v. Comptroller of the Currency*, 577 F. Supp. 252 (D.D.C. 1983), *aff'd per curiam*, 758 F.2d 739 (D.C. Cir. 1985), *reh'g. denied*, 765 F.2d 1196 (D.C. Cir. 1985), *rev'd on the merits*, 479 U.S. _____, 93 L.Ed. 2d 757, 107 S.Ct. 750 (1987).

Since national banks may choose to carry out permissible activities through an operating subsidiary, 12 C.F.R. § 5.34, and because all of the Subsidiary's proposed activities have previously been ruled permissible by this Office, there is no objection to your converting the Subsidiary from a bank service corporation to an operating subsidiary of the Bank and engaging in the specific activities listed above. Further, the Subsidiary may engage in any other agency activity that has been approved by the OCC for discount-brokerage operating subsidiaries. However, we are unable to grant your request for authority to engage in all securities activities that may be authorized in the future.

J. Michael Shepherd
Senior Deputy Comptroller for
Corporate and Economic Programs

* * *

416—February 16, 1988

Mr. Timothy A.G. Gerhold
Assistant General Counsel
First National Bank of Boston
Boston, Massachusetts 02106

Dear Mr. Gerhold:

This is in response to your letter of April 8, 1987, and a follow-up letter dated June 22, 1987, providing notification of intent to establish a new operating subsidiary of First National Bank of Boston (the Bank), as required by the Office's regulation at 12 C.F.R. § 5.34. BancBoston Receivables, Inc. (the Subsidiary) will engage in the general business of purchasing loan assets from the Bank and selling them to an independent third party. For the

reasons set forth below, it is my opinion that the Subsidiary's intended activities are permissible and that the Bank may therefore go forward with its proposal.

According to the information provided in your letter, the Subsidiary will from time to time purchase from the Bank loans, leases, installment sales contracts, and various other types of loan assets. It will sell these assets, or participations in them, to unaffiliated third parties. These parties in turn will issue bonds, certificates, or other securities evidencing ownership interests in, or collateralized by, the loan assets. Neither the Bank nor the Subsidiary will underwrite or deal in the bonds, certificates, or securities payable from or collateralized by the loan assets. The Bank or the Subsidiary will enter into servicing agreements with respect to the sold loan assets, obtain letters of credit or other forms of credit support from unaffiliated institutions, and generally take such other actions as may be necessary or incidental to the accomplishment of the foregoing.

As further indicated in your letter, a specific example of the type of transaction contemplated would be the following. The Bank has a dealer paper program in which selected automobile dealers in the Bank's area originate motor vehicle retail installment sales contracts in accordance with the Bank's current credit standards. The Bank purchases contracts from dealers after a credit review by Bank personnel. It is planned that the Subsidiary would purchase the contracts from the Bank and sell them to an unaffiliated special purpose trust (the Trust). The Trust in turn would issue and sell, through a public offering underwritten by an investment bank, fixed-rate certificates evidencing undivided fractional interests in the pool of contracts held by the Trust. The certificates would be payable from the collections on the contracts and from any necessary drawings on a letter of credit issued by an unaffiliated bank that guarantees the Trust against loss on an as yet undetermined percentage of the pool of contracts held by the Trust. Neither the Trust nor the holders of the certificates would have recourse to the Bank or the Subsidiary except for breach of the representations made in connection with the sale of the contracts. Aside from that, the certificate holders would look only to the proceeds from the contracts and the letter of credit for payment, and the letter of credit bank would have recourse only to amounts deposited in a special reserve fund which would result from the difference between the rate of interest payable on the contracts. The Bank would continue to service the contracts for the Trust under a servicing agreement and would receive a servicing fee. The Bank would also retain the right to receive the excess in the fund over what is required to satisfy the letter of credit bank.

Since its enactment, the National Bank Act of 1864 has authorized national banks to "carry on the business of

banking; by discounting and negotiating promissory notes, . . . and other evidences of debt" 12 U.S.C. § 24 (Seventh). The term "negotiating" authorizes a bank's transfer of its notes or other evidences of debt acquired in the course of the banking business. See *Danforth v. National State Bank*, 48 F. 271 (3d Cir. 1891); *First National Bank of Salem v. Elmer*, 278 S.W. 826 (Mo. App. 1926). The Supreme Court has long recognized that the negotiation of evidences of debt acquired through a national bank's express authority to lend money on the security of real estate is authorized as part of the business of banking under 12 U.S.C. § 24 (Seventh). *First National Bank of Hartford v. City of Hartford*, 273 U.S.C 548 (1927). Since national banks are also expressly authorized by the same statute to make loans on personal security, that reasoning is equally applicable here. The sale by a national bank of loan assets through its operating subsidiary to a trustee constitutes the negotiation of evidences of debt as expressly authorized by 12 U.S.C. § 24 (Seventh).

In addition to the express power to negotiate evidences of debt, the National Bank Act also gives national banks "all such incidental powers as shall be necessary to carry on the business of banking." 12 U.S.C. § 24 (Seventh). A variety of tests for incidental powers has been propounded by the courts over the years, but even the most restrictive test — that enunciated by the First Circuit in the *Arnold Tours* case — permits the sale of loan assets in the proposed manner. In *Arnold Tours, Inc. v. Camp*, 472 F.2d 427 (1st Cir. 1972), the court found that an activity qualifies as an incidental power if it is "convenient or useful" to an expressly authorized banking power. The sale of loan assets to a trustee, who will subsequently issue pass-through certificates representing ownership interests in such assets, can be "convenient or useful" to a bank's express power to loan money on personal security. Such sales provide liquidity and enable the Bank to fund new loans.

In a more general sense, the ability to sell bank assets acquired in its ordinary course of business is certainly "necessary to carry on the business of banking." The unrestricted ownership of property connotes the ability to transfer that property by sale or otherwise, and sound management practice may require that banks sell or transfer their assets as business conditions warrant. See letter of Emory W. Rushton, Deputy Comptroller for Multinational Banking, [Current Developments] Fed. Banking L. Rep. (CCH) ¶ 85,602 (March 24, 1987).

Nor is the sale of Bank loan assets prohibited by the Glass-Steagall Act. Section 16 of the Act, 12 U.S.C. § 24 (Seventh), limits the extent to which national banks can deal in and underwrite securities. The Bank's program will not be affected by this provision because the pass-through certificates or other securities will be issued and underwritten by a third party, not by the Bank or its Subsidiary. The

Bank and the Subsidiary also will not be dealing in the instruments in the secondary market. Simply stated, neither one will engage in any securities activity within the purview of the Glass-Steagall Act.

It is my opinion that the recently enacted moratorium on the Office's approval of certain bank securities activities is not applicable to your proposal. Section 201(b) of the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86 Stat. 552, provides in relevant part:

(2) A Federal banking agency may not authorize or allow by action, inaction, or otherwise . . . any insured bank or subsidiary or affiliate thereof to engage in the United States to any extent whatever —

. . . .

(B) in any securities activity not legally authorized in writing prior to March 5, 1987

The Bank and its Subsidiary will not be engaging in any "securities activity" under your proposal. As outlined above their activity will be limited to the purchase and sale of loan assets, a traditional banking function expressly authorized by the National Bank Act, 12 U.S.C. § 24 (Seventh).

In sum, the Bank's program is fully consistent with the national banking laws and the precedents of this Office and is not prohibited by the Glass-Steagall Act. This conclusion is based upon the activities described in your letters of April 8 and June 22, 1987, and telephone conversations with members of your staff. Any material change in the program as you have described it might require a different conclusion, and I understand that you will file an appropriate notification if you desire additional authority for the Subsidiary to engage in additional activities in the future.

J. Michael Shepherd
Senior Deputy Comptroller for
Corporate and Economic Programs

* * *

417—February 17, 1988

February 17, 1988

Frederick W. Geissinger
Vice President
The Chase Manhattan Bank, N.A.
101 Park Avenue, 15th Floor
New York, N.Y. 10081

Dear Mr. Geissinger:

This is in response to your letter of March 16, 1987, giving notice of a proposal by The Chase Manhattan Bank.

National Association (the Bank) to establish a *de novo* operating subsidiary (the Subsidiary) to engage with the Bank in the creation and sale of certificates representing interests in pools of mortgages selected from the Bank's real estate loan portfolio. The summary set forth in this letter is based on your letter, the letter of Sanford W. Morhouse, Bank Counsel, dated March 16, 1987, and the telephone conversations of Mr. Morhouse and his associate Henry Morriello with Barrett Aldemyer of this Office. It is the Office's understanding that these same activities are about to be performed or are currently being performed in the Bank.

The Bank's Proposal

The certificates, which are to be issued by the Subsidiary or the Bank, represent fractional, undivided interests in a pool of the Bank's mortgage loans. The holders of the certificates will receive principal and interest payments on the pooled mortgages at stated pass-through rates. The mortgages in the pools will chiefly represent commercial real estate loans, either short-term construction loans or long-term permanent loans, but the pools might include residential loans, either in combination with the commercial loans or in separate pools. The mortgages in each pool will be assigned without recourse from the Bank or the Subsidiary to a trustee. The trustee will be either the Bank's corporate trust department or an independent banking institution.

After a pool has been established, the Bank or the Subsidiary will not exchange or substitute mortgages for mortgages in the pool. The Bank or the Subsidiary will also not repurchase any mortgage except when the mortgage fails to meet certain specified representations or when in certain instances the pool has been amortized to 10 percent or less of the original amount, in which case the Bank or the Subsidiary may have a repurchase option.

Fees for the servicing of the mortgage loans will be established for the Bank or the Subsidiary under the pooling and servicing agreement of each pool. The Subsidiary may further subdelegate its servicing functions to the Bank.

The certificates will be marketed by the Bank, the Subsidiary, or an independent investment company in the manner of a private placement. Thus, they will be marketed only in large denominations to a limited number of institutional investors and with limited advertising. Although the certificates will be marketed in the manner of a private placement, they may be registered with the Securities and Exchange Commission to provide investors with the disclosure information incidental to the registration process. The certificates may also be submitted for rating by a nationally recognized rating agency.

The following forms of credit enhancement may be used singly or in combination in connection with the sale of the certificates:

- (1) mortgage guarantee insurance and hazard insurance policies covering up to a specified percentage of the aggregate principal balance of the mortgages in the pool;
- (2) in the event of delinquencies in the payment of the pooled loans the Bank or some other financial institution may make advances to certificate holders, pending receipt of payments under the independent mortgage guarantee insurance, but any advances will be limited to the amount reimbursable under the independent mortgage guaranty insurance policy obtained;
- (3) a letter of credit from the Bank or another financial institution backing the pooled mortgages in an amount equal to a specified percentage of the aggregate principal balance of the mortgages in the pool; and
- (4) a limited guaranty by another financial institution or other entity with respect to the pooled mortgages equal to a specified percentage of the aggregate principal balance of the mortgages in the pool.

Accounting Treatment

Whether the pool consists of commercial loans, residential loans, or a combination of both, the transfer of the mortgages from the Bank's portfolio to the pool and the sale of the certificates will with one exception be a sale of assets because the Bank does not retain any risk of loss on the underlying loans. The Bank will retain no liability except as trustee and will be under no obligation to repurchase any mortgages unless they fail to meet the specified representations in the proposal or unless repurchase is necessary to provide for the orderly closing of the pool when it has been amortized to 10 percent or less. These provisos have been considered by the Office as consistent with a sale of assets. See OCC Letter No. 92 (April 20, 1979), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,167.

The only exception to this rule occurs when the Bank retains some degree of risk by issuing its own letter of credit. The Office has previously approved the use of a bank's own letter of credit in support of a bank-issued mortgage-backed certificate program. See OCC Letter No. 132 (February 1, 1980), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,213. As further explained in the following discussion, a transaction involving such a letter of credit might be considered either a sale of assets or a

borrowing for bank accounting purposes, depending on the nature of the loans in the pool and the risk of loss retained by the Bank.

If the pool consists partially or entirely of commercial loans and the Bank issues its own letter of credit, the transaction will be reported as a borrowing on the Bank's quarterly Call Report:

If risk of loss or obligation for payment of principal or interest is retained by, or may fall back upon, the seller, the transaction must be reported by the seller as a borrowing from the purchaser and by the purchaser as a loan to the seller.¹

The Call Report Instructions further specify that the entire proceeds of the transaction should be reported as a borrowing, even if, as in the present case, the letter of credit is in an amount equal to a specified percentage of the aggregate principal balance of the pooled mortgages:

If assets are sold subject to the specific contractual terms that limit the seller's risk to a percentage of the value of the assets sold or to a specific dollar amount, the entire proceeds from the transaction shall be reported as a borrowing transaction between the seller and the purchaser and the entire carrying amounts of the transferred assets shall continue to be reported as assets by the seller. For example, if assets are sold subject to a ten percent recourse provision (*i.e.*, the seller's risk is limited to ten percent of the value of the assets sold), the total amount of the proceeds is reported as a borrowing, not just the ten percent limit.²

Thus, if the pool consists partially or exclusively of commercial mortgages and is backed by a Bank-issued letter of credit, the entire proceeds would be considered as a borrowing and the commercial loans would be retained on the Bank's books.

If the pool consists entirely of residential loans and is backed by the Bank's own letter of credit, the transaction would be reported as a sale of assets if the Bank does not retain "any significant risk of loss, either directly or indirectly."³ If, on the other hand, any significant risk of loss arising from the underlying residential mortgages is retained by the Bank, the transaction would need to be reported as a borrowing.⁴ Thus, if the "specified per-

centage of the aggregate principal balance" covered by the letter of credit constituted a significant risk of loss, the transaction would be reported as a borrowing and the residential loans would be retained on the Bank's books

Legal Analysis

Banking

The proposal involves a sale of Bank assets, or, in certain circumstances, if the Bank issues a letter of credit, a borrowing of funds. Both of these activities — sale of assets and borrowing of funds — are permissible national bank activities.

The sale of bank assets is within the express statutory authority of national banks. The corporate powers provisions of 12 U.S.C. § 24 (Seventh), in language unchanged since their original enactment in 1864, authorize national banks

to exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating [*i.e.*, buying and selling] promissory notes, drafts, bills of exchange, and other evidences of debt . . .

The right to discount and negotiate includes both the right to buy and to dispose of evidences of debt. *See, e.g., Danforth v. National State Bank of Elizabeth*, 48 F. 217 (3rd Cir. 1891); *Morris v. Third National Bank of Springfield*, 142 F.25 (8th Cir. 1905), *cert. denied*, 201 U.S. 649 (1906). The Bank's proposal obviously falls within this permission.

There is both judicial support and additional statutory support for the authority of national banks to sell their mortgage-related assets. For example, the U.S. Supreme Court in *First National Bank of Hartford v. City of Hartford*, 273 U.S. 548, 559-60 (1927), determined that national banks could sell real estate mortgages and other evidences of debt lawfully acquired in the exercise of a national bank's express statutory authority to make real estate loans and to discount and negotiate other evidence of debt. *See also* Letter from Robert L. Clarke, Comptroller of the Currency, to Russell A. Freeman, Security Pacific National Bank, June 16, 1987 ("Security Pacific Letter"). And 12 U.S.C. § 371(a), as recently amended, authorizes national banks to

make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate, subject to such terms, conditions, and limitations as may be prescribed by the Comptroller of the Currency by order, rule, or regulation.

The OCC's implementing regulation, 12 C.F.R. Part 34, imposes no limitations on the sale of real estate loans or

¹See "Sales of Assets," Instructions, Consolidated Reports of Condition and Income for Insured Commercial Banks with Domestic and Foreign Offices (Reporting Form Federal Financial Institutions Examination Council 031), hereafter Call Report.

²*Id.*

³Call Report, "Participations in Pools of Residential Mortgages."

⁴*Id.*

interests therein. Indeed, the purchase and sale of interests in loans (commonly referred to as loan participations) is a traditional banking activity. See OCC Banking Circular 181 (August 2, 1984).

Even without specific statutory authorization, a national bank like any business, can sell some of its assets or interests in those assets from time to time. This is simply an incident of ownership and a necessary device for maintaining adequate liquidity. See Security Pacific Letter, *supra*.

It is also well established that national banks can borrow money. See, e.g., *Wyman v. Wallace*, 201 U.S. 230 (1906); *Aldrich v. Chemical National Bank*, 176 U.S. 618 (1899); *Auten v. United States National Bank of New York*, 174 U.S. 125 (1898). They can pledge assets to secure their borrowings. See, e.g., *Wyman v. Wallace*, *supra*; *Schumacher v. Eastern Bank and Trust Co.*, 52 F. 2d 925 (4th Cir. 1931); *Merchants National Bank*, 238 F. 502 (8th Cir. 1916), OCC Letter No. 378 (March 24, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,602.

The only remaining issue in this context is whether the Bank's borrowing would be characterized as a deposit or as a loan. National banks "lack the power to pledge their assets to secure private deposits." See 12 C.F.R. § 7.7410. However, the proposal under discussion lacks the common indicia of a deposit. See OCC Letter No. 378 (March 24, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,602; see also 12 U.S.C. § 1813(1)(1).⁵ In addition, as noted above, the proposal would not be characterized as a deposit for bank accounting or Call Report purposes.⁶ Insofar as it involves a Bank-issued letter of credit and is characterized as a borrowing rather than a sale of assets, the proposal falls within those cases upholding the authority of national banks to borrow money and pledge assets as collateral.

There is no doubt that the sale of bank assets and the borrowing of funds subject to a pledge of collateral are permissible under national banking laws. Furthermore, it

is well established that the sale of assets can be accomplished through the issuance of mortgage-backed or other asset-backed certificates or participations and that the borrowing of funds can be accomplished by the issuance of debt instruments, including bonds and other debt securities. Over the past decade, the Office has approved a number of transactions which, like the present Bank proposal, involved the sale of interests in mortgage-backed or mortgage-related obligations, whether the transactions represented a sale of the underlying assets or a borrowing of funds. See, e.g., OCC Press Release and Letter of March 30, 1977, *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 97,093; OCC Letter No. 92 (April 20, 1979), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,167; OCC Letter No. 132 (February 1, 1980), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,213; OCC Letter No. 251 (September 17, 1982), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,415; OCC Letter No. 257 (April 12, 1983), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,421; OCC Letter No. 362 (May 22, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,532; Security Pacific Letter, *supra*. Like the present proposal, many of these transactions also involved the transfer of participations in banks' own non-federally insured mortgages. See, e.g., OCC Press Release and Letter of March 30, 1977, *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 97,093; OCC Letter No. 92 (April 20, 1979), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,167; and OCC Letter No. 132 (February 1, 1980), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,213; Security Pacific Letter, *supra*.

Glass-Steagall

Because the activities of the Bank and the Subsidiary in creating and marketing the mortgage-backed certificates are permissible exercises of the Bank's corporate powers, the Glass-Steagall Act does not restrict them. See, e.g., *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 468 U.S. 137, 158 n. 11 (1984) (Glass-Steagall prohibitions do not affect the permissibility of activities which are part of the business of banking). See also Security Pacific Letter, *supra*. Section 16 of the Glass-Steagall reenacted the corporate powers provisions of 12 U.S.C. § 24 (Seventh). There is no indication in the statutory language or the legislative history that Congress intended to limit or remove expressly authorized banking powers. The focus and thrust of the Act was instead to limit banks' participation in the securities business. See discussion of Glass-Steagall hazards, *infra*. Therefore, the Bank's proposal is not subject to the restrictions of the Act.

Even aside from this point, there are at least three reasons why the Act does not bar the activities in question.

First, the mortgage certificates are not Glass-Steagall securities. Second, even if the certificates are assumed

⁵For example, the relationship between the certificateholders and the Bank is not characterized as a deposit relationship in the proposal, and the purchasers of the certificates are investors who expect to obtain principal and interest payments from the pledged mortgage loans.

⁶For purposes of member bank reserve requirements in Regulation D, 12 C.F.R. Part 204, a bank borrowing might be considered a deposit. See 12 C.F.R. §§ 204.2(a)(1)(vii) and (a)(2)(ix). In the event that the transaction is categorized as a borrowing for bank accounting purposes, you should consult the Federal Reserve Board to determine whether the transaction would be categorized as a deposit under Regulation D. Please note, however, that even if the transaction is subject to the reserve requirements, it would not necessarily be a deposit under the Comptroller's Interpretive Ruling 77410, 12 C.F.R. § 77410. The Federal Reserve Board has acknowledged that Regulation D "currently defines as deposits a number of sources of funds that frequently are not classified as deposits for other purposes." 45 Fed. Reg. 56009, 56014 (August 22, 1980).

arguendo to be Glass-Steagall securities, the Bank's activities would not constitute "underwriting" or "dealing" within the meaning of the Act. Third, the activities do not raise the "hazards" which the Supreme Court has determined to be the basis of congressional concern in enacting the Act. Each of these points, summarized below, is elaborated upon in greater detail in the Security Pacific Letter, *supra*.

In determining whether a financial product is a security for purposes of Glass-Steagall, the Supreme Court has looked to the underlying purpose of the Act which was to insulate commercial banks from some of the risks of investment banking. *Investment Company Institute v. Camp*, 401 U.S. 617, 630 (1971) ("*Camp*"); *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 468 U.S. 137, 144-45 (1984) ("*Bankers Trust I*").⁷ Since the Bank's proposed issuance and sale of mortgage-backed certificates do not raise those risks, the certificates are not Glass-Steagall securities. See discussion of Glass-Steagall "hazards," *infra*.

In addition, the certificates are pass-through vehicles. The underlying transaction is the sale of Bank mortgage assets or the borrowing of funds collateralized by those assets. The characteristics of these assets pass through to the certificates which represent undivided participations in the mortgages. Because the mortgage assets are not securities, the participations in these assets are likewise not securities. Nor do the pooling and packaging of these assets alter the fundamental character of the transaction so as to create a Glass-Steagall security. See Security Pacific Letter, *supra*.

Even assuming *arguendo* that the certificates are Glass-Steagall securities, the activities of the Bank and the Subsidiary are not prohibited by the Act because they do not constitute "underwriting" or "dealing" in securities.⁸ As previously indicated, the Supreme Court has identified the chief purpose of the Glass-Steagall Act as the separation of commercial banking from some of the risks investment banking. *Camp*, 401 U.S. at 630. In investment

banking, the terms "underwriting" and "dealing" are generally limited to activities undertaken by an intermediary on behalf of an issuer of securities. Underwriting is commonly understood as the process of facilitating the distribution of newly issued securities to investors by purchasing them from the issuers and coordinating or conducting the sale and distribution of the securities. See Jennings and Marsh, *Securities Regulation* (5th ed 1982), 15-16. Dealing similarly involves buying and selling the securities of others. In contrast, the present proposal does not involve bank intermediation for another issuer. Instead, the Bank or the Subsidiary will create the mortgage pool from the Bank's own mortgage loans and will sell certificates representing interests in those pooled loans. Thus, the Bank and the Subsidiary will simply be selling the Bank's assets or borrowing funds collateralized by those assets. In either case, the Bank will be engaged in activities permissible as part of the business of banking, pursuant to 12 U.S.C. § 24 (Seventh). As indicated in Office opinion letters, Section 16 of Glass-Steagall is intended to control bank purchase and sale of securities issued by others rather than the purchase and sale of interests in the Bank's own assets. See, e.g., OCC Letter No. 378 (March 24, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,602.

Furthermore, because the Bank's sale of the mortgage-backed certificates will be conducted in the manner of a private placement, the offering will not come within the Glass-Steagall Act's meaning of underwriting. The D.C. Circuit Court of Appeals recently held that a commercial bank's private placement of a Glass-Steagall security (commercial paper) did not constitute underwriting for purposes of the Act. *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 807 F.2d 1052, 1062 (D.C. Cir. 1986) (*Bankers Trust II*). The court found that the exclusion of bank private placement activities from Glass-Steagall "underwriting" was consistent with the purposes of the Act and did not raise the "subtle hazards" associated with an impermissible incursion into the realm of investment banking. *Bankers Trust II*, 807 F.2d at 1062-67. The private placement activity of the Bank and the Subsidiary like that in *Bankers Trust II* will involve marketing securities only in large denominations to a limited number of institutional investors and with limited advertising. See *Bankers Trust II*, 807 F.2d at 1064. Thus, the proposal does not involve Glass-Steagall underwriting.⁹

⁷The mere fact that the Bank might register the certificates under the securities laws does not mean that they are securities for Glass-Steagall purposes. *Investment Company Institute v. Conover*, 596 F. Supp. 1496 (D.D.C. 1984), *aff'd* 790 F.2d 925 (D.C. Cir.), *cert. denied, sub nom. Investment Company Institute v. Clarke*, 107 S.Ct. 421 (1986).

⁸Section 16 states:

The business of dealing in securities and stock by the [banking] association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock . . .

Numerous exceptions to these restrictions are listed in Section 16. For example, banks can underwrite and deal in obligations of the United States and general obligations of states or political subdivisions of states.

⁹The OCC, as well as the Federal Reserve Board, has also long maintained that bank private placement activities are legally permissible. See OCC Letter No. 32 (December 9, 1977), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,107, Federal Reserve Board Staff Study, Commercial Bank Private Placement Activities (1977). The private placement of certificates for undivided shares in bank-issued mortgage pools has also been held to be permissible. OCC Letter No. 25 (February 24, 1978), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,100, OCC Letter No. 41 (May 18, 1978), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,116, OCC Letter No. 57 (May 29, 1981), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 87,275. Thus, the private placement activities in the current proposal are within the range of activities approved in Office precedent.

Since the activities of the Bank and the Subsidiary are permissible under Section 16 of the Glass-Steagall Act, the restrictions of Section 21 of the Act are not applicable. Section 21, codified at 12 U.S.C. § 378, prohibits organizations "engaged in the business of issuing, underwriting, selling, or distributing . . . securities" from engaging "in the business of receiving deposits . . ." There are two limitations on the prohibitions of Section 21. First, the prohibitions do not impair the ability of banks to sell investment securities or to issue securities "to the extent permitted to national banking associations by the provisions of section 24 of the title . . ." As interpreted by the D.C. Circuit in *Bankers Trust II*, 807 F.2d at 1056-68, this means that activities permissible under Section 16 cannot be prohibited by Section 21. The court would not even address the meaning of the terms in Section 21 unless it was determined that Section 16 did not provide an answer. *Id.* at 1057. See also *Board of Governors of the Federal Reserve System v. Investment Company Institute*, 450 U.S. 46, 62-63 (1981) (Section 21 does not require banks to abandon banking practices authorized by Section 16).

The second proviso in Section 21 states that its restrictions will not affect the rights which "any bank . . . may otherwise possess to sell, without recourse or agreement to repurchase, obligations evidencing loans on real estate. . . ." Since national banks are empowered under 12 U.S.C. §§ 24 (Seventh) and 371(a) to sell their real estate mortgage assets, Section 21 would not apply to such sales. The legislative history of the provision reflects a congressional interest in promoting the secondary mortgage market. See Letter of Robert L. Clarke, Comptroller of the Currency, to Senator Alfonse M. D'Amato, June 18, 1986. Therefore, the restrictions of Section 21 would not apply to the packaging and sale of the Bank's mortgage assets under the present proposal.

The permissibility of the proposed activities of the Bank and the Subsidiary under the Glass-Steagall Act is further supported by a review of the hazards identified by the courts as the basis for the separation of commercial and investment banking in the Act. See *Camp*, 401 U.S. at 630-38; *Bankers Trust I*, 468 U.S. at 144-48, 154-60; *Bankers Trust II*, 807 F.2d at 1066-69. The chief hazard of combining commercial and investment banking identified by the Supreme Court in *Camp* was that banks might place their funds in imprudent investments. 401 U.S. at 630. This hazard is not present in the current proposal because the Bank is not making investments of any kind, imprudent or otherwise. It is simply issuing and selling participations or interests in its own assets. Therefore, the proposal does not involve the chief risk associated with the mingling of commercial and investment banking.

The subtle hazards associated with the combination of investment and commercial banking are also largely absent from the current proposal. The Bank would not

be making unsound loans to an issuer because the Bank is not dealing with another issuer; it is using its own assets to create the mortgage pools. See *Bankers Trust II*, 807 F.2d at 1067. Similarly, the Bank would not be tempted to make its credit facilities more freely available to companies in which the Bank invested because the Bank is not investing in other firms but is marketing its own assets.¹⁰ See *Camp*, 401 U.S. at 631; *Bankers Trust I*, 468 U.S. at 146-47. Nor would the Bank have occasion to encourage one of its borrowers to issue securities in order to obtain funds to repay Bank loans because in this case the Bank is issuing its own certificates, not those of another entity. *Bankers Trust I*, 468 U.S. at 147. Thus, the absence of another issuer diminishes the likelihood that the Bank will be involved in the subtle hazards of joining investment and commercial banking.

The proposal could affect the Bank's ability to render impartial investment advice to customers seeking to purchase certificates, thus raising one subtle hazard. However, some such risk exists in all transactions in which a bank is selling its products or services to a customer. In addition, this risk was acknowledged to exist in the proposal evaluated by the D.C. Court of Appeals in *Bankers Trust II*. The court found however, that the presence of this single "subtle hazard" did not require the finding that the proposal was in violation of the law. The court noted that the "subtle hazards" lead to the prohibition of a banking practice only when each and every hazard is present. *Bankers Trust II*, 807 F.2d at 1069.

There are no other subtle hazards raised by the Bank's proposal. As indicated above, the absence of another issuer removes a potential incentive for the Bank to tailor the proposal to the needs of the issuer without regard to the integrity of the issue or the needs of Bank customers. In selling its assets and borrowing funds by means of undivided participations in an underlying pool, the Bank is simply extending its traditional practices of selling assets and borrowing funds both in the form of whole loans and notes and of participations in those loans and notes. Thus, the use of the vehicle of mortgage-backed certificates does not shift the basic risks or incentives in practices which are part of the business of banking. The proposal would not encourage the Bank to undermine the soundness of its mortgage-lending policies. The Bank would have no incentive to extend loans imprudently because the marketing of the mortgage-backed certificates would become increasingly difficult

¹⁰One of the forms of credit enhancement which might be offered by the Bank is a Bank-issued letter of credit backing the pooled mortgages in an amount equal to a specified percentage of the balance of the mortgages in the pool. The limited risk to the Bank created by the letter of credit would not encourage the Bank to engage in imprudent banking practices because, without the sale of the Bank's mortgage assets, the Bank would retain the entire risk of default on the loans.

if the quality of the underlying assets declines. The hazards identified by the courts as incidental to the combination of investment and commercial banking are not present in the current proposal.

Moratorium

On August 10, 1987, the Competitive Equality Banking Act, Pub. L. No. 100-86 (CEBA), was signed into law by the President. Section 201(b) of the CEBA places a moratorium on approvals of certain securities activities of banking organizations. Section 201(b) states, in pertinent part:

A Federal banking agency may not authorize or allow by action, inaction, or otherwise . . . any insured bank or subsidiary or affiliate thereof to engage in the United States to any extent whatever

—

(B) in any securities activity not legally authorized in writing prior to March 5, 1987 . . .

Your proposal may be implemented since it falls within the exception in the moratorium for activities authorized in writing prior to March 5, 1987. As stated earlier in this letter (*supra*, pp. 3, 7-8, 11, 14) over the past decade the Office has approved a number of proposals which, like the present proposal, involve the issuance and sale of interests in a bank's pooled mortgages. These letters cover all significant aspects of the proposal, *e.g.*, issuance and marketing of participations in a bank's own non-federally insured mortgages (OCC Press Release and Letter of March 30, 1977, *reprinted in* Fed. L. Rep. (CCH) ¶ 97,093; OCC Letter No. 92 (April 20, 1979), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,167); private placement of interests in mortgage pools (OCC Letter No. 25 (February 14, 1978), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,100); OCC Letter No. 41 (May 18, 1978), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,116); conduct of mortgage-related activities through an operating subsidiary (OCC Letter No. 362 (May 22, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,532); and use of various forms of credit support (OCC Letter No. 92 (April 20, 1979), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,167); OCC Letter No. 132 (February 1, 1980), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,213).

Conclusion

Our conclusion is that the Bank's proposed activities, with respect to the issuance and sale of mortgage-backed obligations from the Bank's real estate mortgage portfolio, are permissible under the authority of 12 U.S.C. §§ 24 (Seventh) and 371(a) and are not prohibited by the Glass-Steagall Act. The activities of a national bank which are a part of or incidental to the business of banking can

also be performed through an operating subsidiary 12 C.F.R. § 5.34(c). Therefore, these same activities can be performed through the Bank's Subsidiary. See OCC Letter No. 362 (May 22, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,532 (business of issuing and selling mortgage-backed instruments can be conducted through an operating subsidiary).

J. Michael Shepherd
Senior Deputy Comptroller
for Corporate and Economic Programs

* * *

418—February 17, 1988

Douglas A. Bacon, Esq.
Senior Counsel
The First National Bank of Boston
Boston, Massachusetts 02106

Re: BancBoston Mortgage Securities, Inc.

Dear Mr. Bacon:

This letter responds to the notification by The First National Bank of Boston (Bank) of its intent to establish a new operating subsidiary, BancBoston Mortgage Securities, Inc. (Mortgage Securities). Mortgage Securities will be a wholly owned subsidiary of an existing wholly owned operating subsidiary of the Bank, BancBoston Mortgage Companies, Inc. (Mortgage Companies). Mortgage Securities is being organized to facilitate the securitization of mortgage assets held by Mortgage Companies and its other mortgage subsidiaries in the course of their mortgage banking business. The Office previously has found similar proposals permissible for national banks. Accordingly, the Office approves the Bank's establishment of Mortgage Securities.

The Bank's Proposal

Our understanding of the Bank's proposal is based upon the Bank's operating subsidiary notification letter, dated March 9, 1987, the Bank's supplemental letter, dated June 18, 1987, and your telephone conversations with Richard H. Cleva, a senior attorney in the Legal Advisory Services Division of this Office.

Mortgage Companies is an existing subsidiary of the Bank which engages in the mortgage banking business both directly and through three wholly owned second-tier subsidiaries. Mortgage Securities will be a wholly owned subsidiary of Mortgage Companies and is being organized to facilitate the sale, in securitized forms, of mortgage assets held by Mortgage Companies, its three other subsidiaries, the Bank, or affiliates of the Bank.

Mortgage Securities will conduct its business from an office located in Jacksonville, Florida which is neither the main office nor a branch of the Bank.

Mortgage Securities is being organized to issue mortgage-related instruments based upon mortgage assets held by its affiliates. In so doing, Mortgage Securities will engage in the following activities. First, it will acquire, own, hold, sell, transfer, assign, pledge, finance, refinance, and/or otherwise deal in (a) fully modified pass-through certificates (GNMA Certificates) guaranteed as to the timely payment of principal and interest by the Government National Mortgage Association (GNMA), (b) mortgage pass-through certificates (FNMA Certificates) guaranteed as to the timely payment of principal and interest by the Federal National Mortgage Association (FNMA), (c) mortgage participation certificates (FHLMC Certificates, and, together with the GNMA Certificates and the FNMA Certificates, Agency Certificates) guaranteed as to the ultimate payment of principal and the timely payment of interest by the Federal Home Loan Mortgage Corporation (FHLMC), and (d) conventional residential mortgage loans.

Second, it will authorize, issue, and deliver bonds or other evidences of indebtedness (in a single or multi-class form) either directly or through grantor trusts established by Mortgage Securities, which bonds or other evidences of indebtedness would be collateralized by a pool of Agency Certificates and/or conventional residential mortgage loans (each such bond or other evidence of indebtedness a Collateralized Mortgage Obligation or CMO). Third, it will authorize, issue, and deliver certificates or other evidences of an ownership interest (in single or multi-class form) in a pool of Agency Certificates and/or conventional residential mortgage loans (each such certificate or other evidence of an ownership a "Pass-Through Certificate"). Fourth, it will authorize, issue, and deliver any other similar instruments, bonds, certificates, evidences of indebtedness or ownership, or securities as may by law be permitted. Fifth, it will engage in other activities incidental to accomplishing the foregoing.

The CMOs or Pass-Throughs issued by Mortgage Securities may be backed by either Agency Certificates or mortgage loans. The Agency Certificates are intended primarily to be Agency Certificates issued by GNMA, FNMA, or FHLMC in exchange for mortgage loans originated by Mortgage Companies or other affiliates of Mortgage Securities. However, it is also intended that Mortgage Securities will supplement such Agency Certificates with other Agency Certificates purchased in the open market.

Of the mortgage loans used to back CMOs or Pass-Throughs issued by Mortgage Securities, approximately fifty percent of the mortgages in Mortgage Securities port-

folio will have been originated by parties unrelated to Mortgage Securities, i.e., correspondent institutions, and approximately fifty percent will have been originated by Mortgage Companies, its subsidiaries, the Bank, and its other subsidiaries and affiliates. Mortgage Companies and its mortgage banking subsidiaries regularly sell and purchase mortgages from other institutions in the secondary mortgage market as a routine part of their mortgage banking business. They purchase only mortgages which comply with Mortgage Companies' own underwriting standards used on direct originations. Those underwriting standards used on direct originations. Those underwriting standards are FNMA/FHLMC standards for conventional loans and FHA/VA standards for FHA and VA loans, as applicable. Any mortgages purchased by Mortgage Companies or its subsidiaries are reviewed to ensure that they meet or exceed these standards. Whether originated by Mortgage Companies and its affiliates or purchased, it is expected that substantially all of the conventional residential mortgage loans acquired by Mortgage Securities and used to collateralize CMOs or underlie Pass-Through Certificates issued by Mortgage Securities will be loans serviced by Mortgage Companies, its subsidiaries, or other affiliates of the Bank.

Transactions would be structured as follows: Mortgage Securities would purchase the mortgage loans or Agency Certificates from the affiliates referred to above and would then issue and sell the CMOs or Pass-Through Certificates to the underwriter, securing them with a pledge of the mortgages or Agency Certificates to a trustee. The proceeds of each issuance of CMOs or Pass-Through Certificates will be used to purchase the collateral necessary to secure the CMOs or to purchase the mortgage interests underlying the Pass-Through Certificates. It is presently contemplated that the CMOs or Pass-Through Certificates proposed to be issued by Mortgage Securities would be issued in a number of series under a pooling agreement, indenture, or similar document between Mortgage Securities or a trust established by Mortgage Securities and an unaffiliated trustee, and would bear interest at rates to be determined for each series. Mortgage Securities may elect to treat certain of the CMOs or Pass-Through Certificates issued as regular or residual interests in a real estate mortgage investment conduit (REMIC) under the Internal Revenue Code of 1986.

The CMOs or Pass-Through Certificates issued by Mortgage Securities would be registered with the Securities and Exchange Commission under the Securities Act of 1933. The holders of any CMOs or Pass-Through Certificates issued by Mortgage Securities would not have any recourse against the Bank, Mortgage Companies, its mortgage subsidiaries, or any other affiliate of the Bank (except against Mortgage Securities in the case of a CMO issued by Mortgage Securities directly). The only recourse of the holders of any CMOs (other than those issued by

Mortgage Securities directly) or Pass-Through Certificates would be to exercise their rights with respect to such collateral or such underlying mortgage interests, as the case may be, and to enforce the guaranty of any third party, such as GNMA. This fact would be brought prominently to the attention of prospective investors, who would also be specifically informed that the CMOs or Pass-Through Certificates do not represent bank deposits and are not insured by the Federal Deposit Insurance Corporation.

The Bank has engaged the services of an independent, unrelated investment banking firm to act as underwriter for the initial offering by Mortgage Securities. The Bank, Mortgage Securities, and other affiliates do not intend to engage in activities which would cause them to be treated as underwriters of Mortgage Securities' issuances under the federal securities laws.

In addition, the Bank will not finance any purchaser's acquisition of the CMOs or Pass-Through Certificates, will not purchase any of the CMOs or Pass-Through Certificates for any trust or agency account as to which it has investment discretion or for the Bank's pension accounts, will not promote the CMOs or Pass-Through Certificates, and will not lend money to Mortgage Securities.

Discussion

These activities — *i.e.*, participation in the mortgage banking business including the buying and selling of mortgage assets (and lending or borrowing collateralized by mortgage assets) in both direct and securitized formats — are permissible activities for national banks and their subsidiaries and have been previously approved by this Office. Accordingly, we believe the proposed activities of Mortgage Securities are permissible and approve the Bank's proposal.

The origination and making of real estate loans on the part of the bank; the purchase and sale of real estate loans and participations therein; and the originating, warehousing, and servicing of loans on behalf of other investors are centrally traditional banking activities. *See, e.g.*, 12 U.S.C. §§ 24(7) & 371(a); 12 C.F.R. § 34.1; 12 C.F.R. § 7.7379; *First National Bank of Hartford v. City of Hartford*, 273 U.S. 548, 559-60 (1927).

This mortgage banking business includes making loans and holding them in portfolio, making loans and selling them on to other lenders, purchasing loans from other loan-originators and holding them, purchasing loans and selling them on, and servicing loans. The mix of activities in any given bank's mortgage banking business at any particular time depends on such factors as local lending opportunities, secondary market funding opportunities, and so on.

The Office also believes that the activity of selling mort-

gages into the secondary market, or alternatively raising lendable funds by borrowing in the market secured by mortgages, may be accomplished by the use of the securitized formats which the market has developed in the last decades as well as by direct methods. The securitized formats are tools used to effect the selling, purchasing, borrowing, and lending functions of the secondary market. They were developed so that these market functions could be accomplished more efficiently; but they are mere tools, another means of performing the same functions.

In keeping with this view, the Office, at least as far back as 1977, has approved of national banks' use of pass-through certificates, collateralized mortgage obligations, or similar instruments as vehicles for selling, or borrowing against, mortgage assets. *See, e.g.*, Letter of Robert L. Clarke, Comptroller of the Currency (June 18, 1986) (unpublished) (surveying prior letters and elaborating Office's legal analysis); OCC No-action Letter No. 86-9 (May 22, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 84,015 (bank issuance and sale of CMOs based on pools of agency mortgage certificates and/or mortgage loans); OCC Interpretive Letter No. 257 (April 12, 1983), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,421 (bank selling and dealing in pass-through certificates where pool of loans consists of obligations expressly eligible under section 24(7)); OCC Interpretive Letter No. 92 (April 20, 1979, *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,167 (pool of conventional mortgage loans, bank sale through issuance of pass-through certificates in two classes); OCC Interpretive Letter No. 41 (May 18, 1978), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,116 (pool of conventional mortgage loans, bank sale through issuance of pass-through certificates); OCC Interpretive Letter No. 25 (February 14, 1978), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,100 (pool of conventional mortgages, bank sale through issuance of pass-through certificates, and bank employees marketing the certificates in private placements); Letter of Robert Bloom, Acting Comptroller of the Currency (March 29, 1977), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 97,093 (pool of conventional mortgage loans, bank sale through issuance of pass-through certificates).

In addition, on two more recent occasions, the Office has reiterated its views on national banks' use of pass-through certificates and CMO vehicles. In one letter, in addition to the Office's traditional analysis of the bank's power to use these vehicles, various operational legal, accounting, and reporting questions in the use of CMOs were discussed. *See* OCC Interpretive Letter No. 378 (March 24, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,602. In another letter, the Office considered the additional factual element that the bank participated in the public selling efforts for its pass-through certificates, in addition to using an independent investment bank for sales efforts,

and concluded this activity was also permissible for banks. See OCC Interpretive Letter No. 388 (June 16, 1987), reprinted in Fed. Banking L. Rep. (CCH) ¶ 85,612, *suit pending Securities Industry Association v. Clarke*, No. 87-4505 (S.D.N.Y. filed June 25, 1987).

As can be seen from the foregoing list of prior letters, the activities involved in the Bank's proposal are within the scope of these contemplated in the Office's various prior authorizations from 1977 forward. Indeed, since the Bank intends to use an independent investment bank and will not itself participate in the selling efforts, the Bank's proposal is within the Office's pre-1987 letters and does not involve a factual setting similar to Letter No. 388 of June 16, 1987. Inasmuch as the Office has previously determined these activities to be permissible for national banks, we find the Bank's proposed activities in Mortgage Securities similarly permissible.

Mortgage Securities will conduct its activities from an office which is neither the head office nor a branch of the Bank. However, in our opinion the proposed activities of Mortgage Securities do not include the types of business for which a branch license is required under 12 U.S.C. § 36(f), because its activities do not involve the three types of banking business enumerated in section 36(f) — *i.e.*, making loans, receiving deposits, or paying checks. See *Clarke v. Securities Industry Association*, 479 U.S. ____, 93 L. Ed. 2d 757, 772-75 (1987). Thus, Mortgage Securities' activities may be performed at locations other than branches, and the Bank's proposal is accordingly consistent with 12 U.S.C. § 36.

Finally, the Bank's proposal is not affected by the recently enacted Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 552. In section 201(b) of the Act, Congress passed a temporary moratorium on approvals of certain securities activities of banking organizations. Under section 201(b)(2)(B), a federal banking agency may not authorize a bank to engage "in any securities activity not legally authorized in writing prior to March 5, 1987." Assuming without deciding that the Bank's proposal would involve a "securities activity" within the meaning of the Act, it is nevertheless not covered by the moratorium since the activities in the Bank's proposal are like those authorized in the Office's prior letters from 1977 onward, such as those discussed earlier. Moreover, the Act also does not affect "activities which had been lawfully engaged in prior to March 5, 1987." Because banks have previously engaged in the activities involved in the Bank's proposal (as shown, for example, in the transactions which were the subjects of the Office's prior letters), the Bank's proposal is not affected by the moratorium also under this provision.

Conclusion

As set forth above, the proposed activities of Mortgage

Securities are within the scope of activities previously determined to be permissible for national banks and their operating subsidiaries. Thus, in light of the above precedents and based upon our review of your description of Mortgage Securities' activities and your legal analysis, we believe the proposed activities are permissible. Accordingly, the Bank may proceed with its proposal under 12 C.F.R. § 5.34.

J. Michael Shepherd
Senior Deputy Comptroller
for Corporate and Economic Programs

* * *

419—February 16, 1988

This responds to your November 11, 1987, letter requesting a legal interpretation with respect to various national bank activities in a proposed joint venture to be called ***.

Background

The facts, as described in your letter, are as follows: The three joint venturers are to be two health insurance companies and The Exchange System Limited Partnership (The Exchange). The Exchange is a limited partnership which was established in 1974 to provide ATM and other shared electronic funds transfer services. The Exchange provides the services to its members, to the limited partners, and, on a contractual basis, to other financial institutions. The general partners of The Exchange is The Exchange System, a non-profit membership corporation whose shareholder members include six national banks, a national bank service corporation, state-chartered commercial banks, federal and state-chartered thrifts, and federal and state-chartered credit unions. The limited partners include five national banks, and federal and state-chartered thrifts. The Exchange System is capitalized so as to minimize the likelihood of piercing the corporate veil.

The purpose of *** will be to facilitate settlement and payment of health insurance claims through the use of shared electronic funds transfer technology. *** will develop a data processing system linking health care providers, health care insurers, health care recipients, and their respective depository institutions. It will transmit claims eligibility information, receive and transmit information for claims entry and payment, operate a data base, accomplish payment, and develop and license appropriate software programs to health care providers to enable them to participate.

Specifically, the proposed system will operate as follows: A patient who receives care from a health care provider, such as a doctor, will present his insurance card, *i.e.*, his Blue Cross card, to the doctor. Through *** the doctor will transmit to the health insurance carrier, the doctor's name,

the amount of the claim, the patient's name and health insurance carrier identification number, the date of service, and the services rendered. The health insurance carrier will then determine whether the claim is covered and, if so, to what extent.

If the health insurance carrier determines that the entire claim is covered, it will transmit a request through *** to its financial institution to transfer funds from the health insurance carrier's account to the doctor's account. The doctor's account may be in the same financial institution or in another financial institution in ***. If the health insurance carrier determines that only a part of the claim is covered, the health insurance carrier will transmit a request through *** to debit the patient's account at the patient's financial institution and to credit the doctor's account at the doctor's financial institution. If the health insurance carrier determines that the claim is not covered at all, the patient may pay the bill with a debit card through ***, pay with a credit card, or be billed at a later time. If the insurance carrier to whom the doctor must submit the claim is not in ***, the claim will be printed and mailed to that carrier by *** and there will be no further electronic interaction between the doctor and the carrier over ***.

The transmission signals from the health care providers and the health insurance carriers will be channeled through The Exchange. The Exchange will act both as the conduit for transmission between the health care providers and insurance carriers (i.e., the provider presenting claims and the carrier responding to claims) and as the transmitter of requests for fund transfers to the financial institutions of the provider, carrier, and patient. The Exchange will provide a service bureau to act as a switching system to participating financial institutions of the patient's health care providers and health insurance carriers.

Each of the joint venturers will own a one-third share of ***. The only projected investment of The Exchange will be its contribution of software, valued at \$450,000 and one-third of the start-up expenses, estimated at \$200,000 (under the joint venture agreement, the Exchange will be responsible for developing the system software and providing the service bureau (transmission) services for the system). Each of the two insurance companies has projected an investment of \$650,000.

The role of the participating financial institutions will be to carry out the electronic transfer of funds as directed by the service bureau and, through the Exchange, to develop the software and transmission services necessary to accomplish the basic purpose of ***. No financial institution will be involved in the sale of any insurance, in the processing or adjudication of any insurance claims, or in insurance-related activity of any kind. Neither will

any financial institution place any assets at risk beyond its interest in The Exchange. The total commitment of each national bank in the Exchange, *** or both, will be less than five percent of the bank's primary capital.

Both The Exchange partnership agreement and the *** agreement expressly provide that any alteration or expansion of the partnership or joint venture requires the consent of the financial institutions. The agreements further provide that unanimous consent (or, with respect to ***, a majority of the joint venturers, including the Exchange), is required for important and fundamental actions of the Exchange and ***. Furthermore, the agreements explicitly recognize that *** and the joint venturers are subject to extensive examination, supervision, and regulation by various federal and state regulatory agencies, including the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the National Credit Union Administration.

Discussion

Generally, a national bank may not enter into a partnership nor may it purchase stock in a corporation. Our concern with a national bank as a partner arises from the case of *Merchants National Bank v. Wehrmann*, 202 U.S. 295 (1906), in which the Supreme Court held that it was *ultra vires* for a national bank to become a general partner — and to, thereby, subject itself to unlimited liability for the acts of others. This Office has, however, permitted a national bank to enter into a partnership where the activities of the partnership are limited to those permitted a national bank and where the potential liability of the bank, with respect to the partnership, is limited, e.g., by entering into the partnership by way of a separately incorporated operating subsidiary, see OCC Interpretive Letter No. 381, *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 85,605; OCC Interpretive Letter No. 382, *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 85,606, or where the bank enters into the partnership solely as a limited partner, see Letter of William B. Glidden, Assistant Director, Legal Advisory Services Division (Nov. 13, 1986) (copy attached); Letter of Joseph Pogar, Jr., Regional Counsel (Nov. 1, 1979) (copy attached).

Our concern with national banks purchasing stock in a corporation arises from the language of Section 16 of the Glass-Steagall Act which provides that

[e]xcept as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by [a national bank] for its own account of any shares of stock of any corporation (12 U.S.C. § 24 (Seventh).)

This Office has concluded, however, that this prohibition does not affect a national bank's ability to own the stock

of an operating subsidiary, see 12 C.F.R. § 5.34, or to own stock in a membership corporation formed to provide services to the bank, see Letters of Peter Liebesman, Assistant Director, Legal Advisory Services Division (Dec. 13, 1983; Jan. 26, 1981).

The proposal that you describe falls within the scope of these exceptions to the general prohibitions. First, the involvement of the national banks in The Exchange System, the general partner of The Exchange, is indirect because the banks are merely shareholders of a membership corporation, which presumably limits the potential liability of the banks. Also, the purpose of the partnership is to provide ATM and other shared electronic funds transfer services to financial institutions, activities that are permissible for national banks. See OCC Interpretive Letter No. 289, *reprinted in* [1983-1984] Fed. Banking L. Rep. (CCH) ¶ 85,453; OCC Interpretive Letter No. 160, *reprinted in* [1981-1982] Feb. Banking L. Rep. (CCH) ¶ 85,241, OCC Interpretive Letter No. 153, *reprinted in* [1981-1982] Fed. Banking L. Rep. (CCH) ¶ 85,234.

Similarly, the involvement of national banks as limited partners in The Exchange appears to be permissible because (1) the bank's potential liability is presumably limited to the amount the bank has invested, and (2) the activities of the partnership are limited to those that are permissible for national banks. See Letter of William B. Glidden (Nov. 13, 1986), *supra*; Letter of Joseph Pogar, Jr. (November 1, 1979), *supra*.

The involvement of national banks in *** is also permissible. While the potential liability of the joint venturers, including The Exchange, may be unlimited, the potential liability of the individual national banks is limited by the limited partnership and membership corporation structure. The issue remains whether the purposes and activities of *** are within the powers of a national bank.

From your description of ***, it appears to us that the primary purpose and activity of the system is intended to be the transfer of funds from the accounts of insurance carriers and individuals to the accounts of health care providers, either within the same financial institution or among several financial institutions. The transfer of funds

from one account to another, or from one financial institution to another, is a fundamental part of the basic business of banking and, as such, is clearly a permissible activity. See 12 C.F.R. Part 205 (electronic funds transfers); 12 C.F.R. Part 210, Subpart B (wire transfers).

What makes the *** system different from other electronic funds transfer systems is the additional element of transmitting treatment information from the health care providers to the insurance carriers. On the *** system, the health care provider identifies itself (the potential payee) and transmits the amount of the claim (the amount of the potential payment), the date of service, the patient's name (the potential payor), the patient's insurance identification number (which identifies another potential payor), and the services that the health care provider has rendered. All this information is strictly identification and amount information, information customarily transmitted when performing electronic funds transfers, except for the date and description of the services that the health care provider has rendered. That information is used by the insurance carrier as the basis for determining how the amount to be paid will be allocated among the potential payors, the patient, and the carriers. We conclude that the addition of this information does not make involvement in *** an impermissible activity for a national bank. The primary purpose of the system is to provide electronic funds transfer services from one account to another, in various financial institutions; transmitting treatment information is an integral part of, and a proper incident to, performing those services.

Finally, we also note that *** expects to develop software and license it to health care providers to enable them to participate in ***. This is an activity which the OCC has previously approved. See Letter of Peter Liebesman, Assistant Director, LASD (Dec. 13, 1985) (copy attached).

I trust that this has been responsive to your inquiry.

William B. Glidden
Assistant Director
Legal Advisory Services Division

* * *

Mergers—January 1 to March 31, 1988

Mergers consummated involving two or more operating banks.

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Merger	127	Security Bank of Denver, National Association, Denver, Colorado	
February 11, 1988		Merger	130
The American National Bank of Bristow, Bristow, Oklahoma		March 10, 1988	
First State Bank, Olton, Oklahoma		First National Bank of Alvin, Alvin, Texas	
Merger	128	First American Bank and Trust of Manvel, Manvel, Texas	
February 11, 1988		Merger	130
Texas Commerce Bank, National Association, Houston, Texas		March 11, 1988	
First Houston Bank, National Association, Houston, Texas		Community National Bank and Trust Company of New York, Staten Island, New York	
Merger	128	First Inter-County Bank of New York, New York, New York	
January 15, 1988		Merger	130
The First National Bank of Lake Forest, Lake Forest, Illinois		March 11, 1988	
First National Bank of Lake Bluff, Lake Bluff, Illinois		The Moody National Bank of Galveston, Galveston, Texas	
Lake Forest National Bank, Lake Forest, Illinois		South Shore National Bank, League City, Texas	
Merger	128	Merger	131

March 11, 1988		March 25, 1988	
Shawmut Bank of Southeastern Massachusetts, National Association, New Bedford, Massachusetts		Bank of Boston-Florida National Association Palm Beach Florida	
Shawmut Bank of Cape Cod, National Association, Orleans, Massachusetts		First Trust Company of Florida National Association Sarasota, Florida	
Merger	131	Merger	133
March 12, 1988:		March 25, 1988	
The First National Bank of Springfield, Springfield, Illinois		Lincoln National Bank, Oklahoma City, Oklahoma	
Land of Lincoln Bank, Springfield, Illinois		First National Bank of Del City Del City, Oklahoma	
Merger	131	Merger	134
March 16, 1988:		March 25, 1988:	
The Gettysburg National Bank, Gettysburg, Pennsylvania		Mercantile Bank, National Association, Clayton Missouri	
Community National Bank of Southern Pennsylvania, Littlestown, Pennsylvania		Mercantile Bank of St. Charles County, National Association, St. Charles, Missouri	
Merger	131	Merger	134
March 17, 1988:		March 31, 1988:	
Liberty National Bank and Trust Company of Indiana, Corydon, Indiana		Centerre Bank of South Kansas City, National Association, Kansas City, Missouri	
First Indiana Bank, National Association, Milltown, Indiana		Centerre Bank of Kansas City, National Association, Kansas City, Missouri	
Merger	132	Merger	134
March 18, 1988:		March 31, 1988:	
The Connecticut National Bank, Hartford, Connecticut		First Midwest Bank/Moline, A National Association, Moline, Illinois	
Shawmut Fidelity Bank, Stamford, Connecticut		First Midwest Bank/Knox County, National Association, Galesburg, Illinois	
Shawmut Home Bank, Meriden, Connecticut		Merger	135
Merger	132	March 31, 1988:	
March 18, 1988:		First National Bank of Aliceville, Aliceville, Alabama	
The Frost National Bank of San Antonio, San Antonio, Texas		Bank of Gordo, Gordo, Alabama	
Citizens Frost Bank, National Association, San Antonio, Texas		Merger	135
Colonial Frost Bank, National Association, San Antonio, Texas		March 31, 1988:	
Liberty Frost Bank, National Association, San Antonio, Texas		The First National Bank of Atlanta, Atlanta, Georgia	
North Frost Bank, National Association, San Antonio, Texas		North Georgia Bank, Canton, Georgia	
Merger	133	Merger	135
March 21, 1988:		March 31, 1988:	
Northern Trust Bank/O'Hare, National Association, Chicago, Illinois		The Hamilton National Bank, Hamilton, Texas	
Northern Trust Bank/Woodfield, Schaumburg, Illinois		First Bank & Trust, Tomball, Texas	
Merger	133	Merger	135
March 24, 1988:		March 31, 1988:	
The Fourth National Bank of Tulsa, Tulsa, Oklahoma		National Bank of Detroit, Detroit, Michigan	
Century Bank, Tulsa, Oklahoma		Pontiac State Bank, Pontiac, Michigan	
Merger	133	Merger	135

There are a number of transactions in this section that do not have an accompanying decision. In those cases, the OCC reviewed the competitive effects of the proposals by using its standard procedures for determining whether the transaction had minimal or no adverse competitive effects. The Office found the proposals satisfied its criteria for a transaction that clearly had no or minimal adverse competitive effects.

COMMERCE BANK OF KANSAS CITY, NATIONAL ASSOCIATION

Kansas City, Missouri, and Commerce Bank of Lee's Summit, National Association, Lee's Summit, Missouri

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Commerce Bank of Kansas City, National Association, Kansas City, Missouri (15985), with	\$1,397,214,000
and Commerce Bank of Lee's Summit, National Association, Lee's Summit, Missouri (17946) with	16,021,000
merged January 1, 1988, under charter and title of the former. The merged bank at date of merger had	1,411,778,000

* * *

THE FIRST NATIONAL BANK OF AMARILLO,

Amarillo, Texas, and First Bank of Amarillo, Amarillo, Texas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The First National Bank of Amarillo, Amarillo, Texas (4214), with	\$ 739,761,000
and First Bank of Amarillo, Amarillo, Texas, with	29,644,000
merged January 1, 1988, under charter and title of the former. The merged bank at date of merger had	769,360,000

* * *

THE FIRST NATIONAL BANK OF ATLANTA,

Atlanta, Georgia, and The First National Bank of Dalton, Dalton, Georgia

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The First National Bank of Atlanta, Atlanta, Georgia (1559) with	\$7,373,331,000
and The First National Bank of Dalton, Dalton, Georgia (3907), with	285,944,000
merged January 1, 1988, under charter and title of the former. The merged bank at date of merger had	7,656,859,000

* * *

FIRST NATIONAL BANK OF SIDNEY,

Sidney, Nebraska, and Dalton State Bank, Dalton, Nebraska

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
First National Bank of Sidney, Sidney, Nebraska (18339), with	\$ 7,532,000
and Dalton State Bank, Dalton, Nebraska, with	12,228,000
merged January 1, 1988, under charter of the former and title "First National Bank". The merged bank at date of merger had	19,760,000

* * *

KEY BANK OF NORTHERN NEW YORK, N.A.,

Watertown, New York, and Key Bank of Central New York, Syracuse, New York

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Key Bank of Northern New York, N.A., Watertown, New York (2657), with	\$ 685,646,000
and Key Bank of Central New York, Syracuse, New York, with	1,380,031,000
merged January 1, 1988, under charter 18756 and title "Key Bank of Central New York, N.A." in Syracuse. The merged bank at date of merger had	2,065,677,000

* * *

NORWEST BANK FARGO, NATIONAL ASSOCIATION,

Fargo, North Dakota, and Norwest Bank Bismarck, National Association, Bismarck, North Dakota, and Norwest Bank Grafton, National Association, Grafton, North Dakota, and Norwest Bank Hillsboro, National Association, Hillsboro, North Dakota, and Norwest Bank Jamestown, National Association, Jamestown, North Dakota, and Norwest Bank Mandan, National Association, Mandan, North Dakota, and Norwest Bank Minot, National Association, Minot, North Dakota, and Norwest Bank Valley City, National Association, Valley City, North Dakota, and Norwest Bank Wahpeton, National Association, Wahpeton, North Dakota, and Norwest Capital Management & Trust Co., Fargo, North Dakota

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Norwest Bank Fargo, National Association, Fargo, North Dakota (2377), with	\$ 186,933,000
and Norwest Bank Bismarck, National Association, Bismarck, North Dakota (13398), with	163,467,000
and Norwest Bank Grafton, National Association, Grafton, North Dakota (3096), with	67,311,000
and Norwest Bank Hillsboro, National Association, Hillsboro, North Dakota (21124), with	43,150,000
and Norwest Bank Jamestown, National Association, Jamestown, North Dakota (2580), with	75,459,000
and Norwest Bank Mandan, National Association, Mandan, North Dakota (2585), with	103,341,000
and Norwest Bank Minot, National Association, Minot, North Dakota (6429), with	165,097,000
and Norwest Bank Valley City, National Association, Valley City, North Dakota (13385), with	54,055,000
and Norwest Bank Wahpeton, National Association, Wahpeton, North Dakota (4552), with	62,341,000
and Norwest Capital Management & Trust Co., Fargo, North Dakota, with	1,827,000
merged January 1, 1988, under charter of the 2377 and title "Norwest Bank North Dakota, National Association." The merged bank at date of merger had	916,750,000

* * *

NORWEST BANK MINNEAPOLIS, NATIONAL ASSOCIATION,

Minneapolis, Minnesota, and Norwest Bank Bloomington, N.A., Bloomington, Minnesota, and Norwest Bank Calhoun-Isles, National Association, Minneapolis, Minnesota, and Norwest Bank Camden, National Association, Minneapolis, Minnesota, and Norwest Bank Central, National Association, Minneapolis, Minnesota, and Norwest Bank East St. Paul, National Association, St. Paul, Minnesota, and Norwest Bank Hastings, National Association, Hastings, Minnesota, and Norwest Bank Jordan, National Association, Jordan, Minnesota, and Norwest Bank Maple Grove, National Association, Maple Grove, Minnesota, and Norwest Bank Metro South, National Association, Minneapolis, Minnesota, and Norwest Bank Metro West, National Association, Hopkins, Minnesota, and Norwest Bank Midland, National Association, Minneapolis, Minnesota, and Norwest Bank Old St. Anthony, National Association, Minneapolis, Minnesota, and Norwest Bank South St. Paul, National Association, South St. Paul, Minnesota, and Norwest Bank St. Paul, National Association, St. Paul, Minnesota, and Norwest Bank Stillwater, National Association, Stillwater, Minnesota, and Norwest Bank University-Midway, National Association, Minneapolis, Minnesota

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Norwest Bank Minneapolis, National Association, Minneapolis, Minnesota (2006), with	\$6,587,035,000
and Norwest Bank Bloomington, N.A., Bloomington, Minnesota (14681), with	327,474,000
and Norwest Bank Calhoun-Isles, National Association, Minneapolis, Minnesota, (13140), with	171,682,000
and Norwest Bank Camden, National Association, Minneapolis, Minnesota (20630), with	124,011,000
and Norwest Bank Central, National Association, Minneapolis, Minnesota (13108), with	202,443,000
and Norwest Bank East St. Paul, National Association, St. Paul, Minnesota (21126), with	102,208,000
and Norwest Bank Hastings, National Association, Hastings, Minnesota (11212), with	75,280,000
and Norwest Bank Jordan, National Association, Jordan, Minnesota (21128), with	27,123,000
and Norwest Bank Maple Grove, National Association, Maple Grove, Minnesota (20632), with	126,635,000
and Norwest Bank Metro South, National Association, Minneapolis, Minnesota (13066), with	83,855,000
and Norwest Bank Metro West, National Association, Hopkins, Minnesota (12518), with	256,613,000
and Norwest Bank Midland, National Association, Minneapolis, Minnesota (9409), with	309,254,000
and Norwest Bank Old St. Anthony, National Association, Minneapolis, Minnesota (13127), with	98,295,000
and Norwest Bank South St. Paul, National Association, South St. Paul, Minnesota (6732), with	93,293,000
and Norwest Bank St. Paul, National Association, St. Paul, Minnesota (12922), with	552,203,000
and Norwest Bank Stillwater, National Association, Stillwater, Minnesota (20634), with	51,473,000
and Norwest Bank University-Midway, National Association, Minneapolis, Minnesota (14517), with	67,581,000
merged January 1, 1988, under charter and title Norwest Bank Minneapolis, National Association, Minneapolis, Minnesota The merged bank at date of merger had	8,742,206,000

* * *

NORWEST BANK MOORHEAD, NATIONAL ASSOCIATION,
Moorhead, Minnesota, and Norwest Bank Fergus Falls, National Association, Fergus Falls, Minnesota, and
Norwest Bank Thief River Falls, National Association, Thief River Falls, Minnesota

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Norwest Bank Moorhead, National Association, Moorhead, Minnesota, (13297), with	\$ 114,512,000
and Norwest Bank Fergus Falls, National Association, Fergus Falls, Minnesota (2648), with	83,644,000
and Norwest Bank Thief River Falls, National Association, Thief River Falls, Minnesota (21125), with	58,309,000
merged January 1, 1988, under charter 13297 and title "Norwest Bank Minnesota West, National Association" in Moorhead. The merged bank at date of merger had	251,991,000

* * *

ONE VALLEY BANK, NATIONAL ASSOCIATION,
Charleston, West Virginia, and Bank of Lubeck, Lubeck, West Virginia

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
One Valley Bank, National Association, Charleston, West Virginia (16433), with	\$ 833,327,000
and Bank of Lubeck, Lubeck, West Virginia, with	15,329,000
merged January 2, 1988, under charter and title of the former. The merged bank at date of merger had	848,522,000

* * *

ST. PAUL NATIONAL BANK,
St. Paul, Nebraska, and Peoples State Bank, Wolbach, Nebraska

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
St. Paul National Bank, St. Paul, Nebraska (13463), with	\$ 28,707,000
and Peoples State Bank, Wolbach, Nebraska, with	4,538,000
merged January 2, 1988, under charter and title of the former. The merged bank at date of merger had	32,823,000

* * *

TEXAS COMMERCE BANK-HURST, N.A.,
Hurst, Texas, and Texas Commerce Bank of Fort Worth, Fort Worth, Texas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Texas Commerce Bank-Hurst, N.A., Hurst, Texas (15072), with	\$162,704,000
and Texas Commerce Bank of Fort Worth, Fort Worth, Texas	198,321,000
merged January 11, 1988, under charter of the former and title "Texas Commerce Bank-Fort Worth, National Association." The merged bank at date of merger had	361,025,000

* * *

UNITED JERSEY BANK, NATIONAL ASSOCIATION,
Princeton, New Jersey, and United Jersey Bank/Hillsborough, National Association, Hillsborough Township,
New Jersey

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
United Jersey Bank, National Association, Princeton, New Jersey (4872), with	\$614,928,000
and United Jersey Bank/Hillsborough, National Association, Hillsborough Township, New Jersey (16011) with	74,978,000
merged January 15, 1988, under charter and title of the former. The merged bank at date of merger had	689,906,000

* * *

FIRST NATIONAL BANK & TRUST CO. OF WILLISTON,
Williston, North Dakota, and Williston Basin State Bank, Williston, North Dakota

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
First National Bank & Trust Co. of Williston, Williston, North Dakota (14275), with	\$ 115,330,000
and Williston Basin State Bank, Williston, North Dakota, with	14,004,000
merged January 21, 1988, under charter and title of the former. The merged bank at date of merger had	NA

* * *

HIBERNIA NATIONAL BANK,
New Orleans, Louisiana, and United Mercantile Bank, Shreveport, Louisiana

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Hibernia National Bank, New Orleans, Louisiana (13688), with	\$4,799,070,000
and United Mercantile Bank, Shreveport, Louisiana, with	86,324,000
merged January 21, 1988, under charter and title of the former. The merged bank at date of merger had	NA

* * *

THE HUNTSVILLE NATIONAL BANK,
Huntsville, Texas, and Sam Houston National Bank, Walker County, Huntsville, Texas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The Huntsville National Bank, Huntsville, Texas (14353), with	\$ 136,262,000
and Sam Houston National Bank, Walker County, Huntsville, Texas (17363), with	37,609,000
merged January 21, 1988, under charter and title of the former. The merged bank at date of merger had	NA

* * *

MBANK DALLAS, NATIONAL ASSOCIATION,
Dallas, Texas, and MBank Centerville, National Association, Garland, Texas, and MBank Garland, Garland,
Texas, and MBank Grand Prairie, Grand Prairie, Texas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
MBank Dallas, National Association, Dallas, Texas (13743), with	\$8,198,111,000
and MBank Centerville, National Association, Garland, Texas (16297), with	107,068,000
and MBank Garland, Garland, Texas, with	138,268,000
and MBank Grand Prairie, Grand Prairie, Texas, with	158,777,000
merged January 22, 1988, under charter and title of MBank Dallas, National Association. The merged bank at date of merger had	8,425,870,000

* * *

FIRST WISCONSIN NATIONAL BANK OF MADISON,
Madison, Wisconsin, and First National Bank of Waunakee, Waunakee, Wisconsin

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
First Wisconsin National Bank of Madison, Madison, Wisconsin (144), with	\$ 512,068,000
and First Wisconsin Bank of Waunakee, Waunakee, Wisconsin, with	25,679,000
merged January 25, 1988, under charter and title of the former. The merged bank at date of merger had	537,624,000

* * *

ALLIED BANK NORTH BELT, NATIONAL ASSOCIATION,
Houston, Texas, and Allied Pasadena National Bank, Pasadena, Texas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Allied Bank North Belt, National Association, Houston, Texas (17612), with	\$139,077,000
and Allied Pasadena National Bank, Pasadena, Texas (14944) with	102,923,000
merged January 28, 1988, under charter and title of the former. The merged bank at date of merger had	242,005,000

* * *

THE CITIZENS NATIONAL BANK OF DECATUR,
Decatur, Illinois, and The Citizens Bank of Decatur, National Association, Decatur, Illinois

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The Citizens National Bank of Decatur, Decatur, Illinois (4576), with	\$212,370,000
and The Citizens Bank of Decatur, National Association, Decatur, Illinois (21642), with	47,118,000
merged January 29, 1988, under charter and title of the former. The merged bank at date of merger had	259,488,000

* * *

THE ILLINOIS NATIONAL BANK OF SPRINGFIELD,
Springfield, Illinois, and Sangamon Bank and Trust, Springfield, Illinois

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The Illinois National Bank of Springfield, Springfield, Illinois (3548), with.....	\$ 344 565,000
and Sangamon Bank and Trust, Springfield, Illinois, with.....	21,821,000
merged January 29, 1988, under charter and title of the former. The merged bank at date of merger had	366,386,000

* * *

SUN BANK/SARASOTA COUNTY, NATIONAL ASSOCIATION,
Sarasota, Florida, and Mellon Bank (FL) #2, National Association, Sarasota, Florida

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Sun Bank/Sarasota County, National Association, Sarasota, Florida (20982), with.....	\$ 192,137,000
and Mellon Bank (FL) #2, National Association, Sarasota, Florida, (21062), with.....	682,580
merged January 31, 1988, under charter and title of the former. The merged bank at date of merger had	192,820,000

COMPTROLLER’S DECISION

On September 15, 1987, application was made to the Office of the Comptroller of the Currency, pursuant to the Bank Merger Act, 12 U.S.C. 1828(c), for prior authorization to merge Mellon Bank (FL) #2 National Association, Sarasota, Florida (Mellon), into Sun Bank/Sarasota County, National Association, Sarasota, Florida (Sun). The application is based on an agreement finalized between Mellon and Sun on August 28, 1987.

Mellon, a wholly owned subsidiary of Mellon Bank Corporation, is a limited purpose bank engaged only in trust banking. As of December 31, 1986, Mellon managed total trust assets of \$63 million and operated two trust offices in the State of Florida. On the same date, Sun, a wholly owned subsidiary of SunTrust Banks, Inc., managed total trust assets of \$76 million. SunTrust Banks, Inc. offers full service banking and operates 23 banking offices throughout the State of Florida.

The relevant geographic market for this proposal is Sarasota County. Within the relevant market there are approximately twelve institutions offering trust services. The proposed merger would result in only a slight reduction in trust banking competition within the relevant market, since Mellon and Sun are among the market’s smaller competitors. Accordingly, there would be no significant adverse effects on competition.

The Bank Merger Act requires this Office to consider

"...the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served." We find that the financial and managerial resources of both banks do not raise concerns that would cause the application to be disapproved. The future prospects of the resulting bank are considered satisfactory, as are the effects of the proposal on the convenience and needs of the community to be served.

A review of the record of this application and other information available to this Office as a result of its regulatory responsibilities revealed no evidence that the applicant’s record of helping to meet the credit needs of its community, including low and moderate income neighborhoods, is less than satisfactory.

We have analyzed this proposal pursuant to the Bank Merger Act, 12 U.S.C. 1828(c), and find that it will not significantly lessen competition in the relevant market. Other factors considered in evaluating this proposal are satisfactory. Accordingly, the application is approved

December 18, 1987

SUMMARY OF REPORT BY ATTORNEY GENERAL

We have reviewed this proposed transaction and conclude that it would not have a significantly adverse effect on competition.

* * *

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Sun Bank/South Florida, National Association, Fort Lauderdale, Florida (14732), with.....	\$1,789,453,000
and Mellon Bank (FL), National Association, Boca Raton, Florida (17168), with.....	1,733,000
merged January 31, 1988, under charter and title of the former. The merged bank at date of merger had.....	1,791,186,000

COMPTROLLER'S DECISION

On September 15, 1987, application was made to the Office of the Comptroller of the Currency, pursuant to the Bank Merger Act, 12 U.S.C. 1828(c), for prior authorization to merge Mellon Bank (FL) National Association, Boca Raton, Florida (Mellon), into Sun Bank/South Florida National Association, Fort Lauderdale, Florida (Sun). The application is based on an agreement finalized between Mellon and Sun on August 28, 1987.

Mellon, a wholly owned subsidiary of Mellon Bank Corporation, is a limited purpose bank engaged only in trust banking. As of December 31, 1986, Mellon managed total trust assets of \$182 million and operated two trust offices in the State of Florida. On the same date, Sun, a wholly owned subsidiary of SunTrust Banks, Inc., managed total trust assets of \$1.2 billion. SunTrust Banks, Inc. offers full service banking and operates 23 banking offices throughout the State of Florida.

The relevant geographic market for this proposal is the counties of Palm Beach and Broward. The relevant market is saturated with numerous banking competitors. There are 33 institutions, with 60 offices, offering trust services within this market. The Office has reviewed the competitive effects of this proposal and finds that while the transaction would eliminate some direct competition between the proponents, any adverse competitive effects would be mitigated by the presence of numerous other banking alternatives in the relevant and adjacent markets.

The Bank Merger Act requires this Office to consider "...the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served." We find that the financial and managerial resources of both banks do not raise concerns that would cause the application to be disapproved. The future prospects of the resulting bank are considered satisfactory, as are the effects of the proposal on the convenience and needs of the community to be served.

A review of the record of this application and other information available to this Office as a result of its regulatory responsibilities revealed no evidence that the applicant's record of helping to meet the credit needs of its community, including low and moderate income neighborhoods, is less than satisfactory.

We have analyzed this proposal pursuant to the Bank Merger Act, 12 U.S.C. 1828(c), and find that it will not significantly lessen competition in the relevant market. Other factors considered in evaluating this proposal are satisfactory. Accordingly, the application is approved.

December 18, 1987

SUMMARY OF REPORT BY ATTORNEY GENERAL

We have reviewed this proposed transaction and conclude that it would not have a significantly adverse effect on competition.

* * *

ALLIED BANK NORTH BELT, NATIONAL ASSOCIATION,

Houston, Texas, and Allied Mission Bend Bank, Harris County, Texas, and Allied Bank Southwest Freeway, Houston, Texas, and Allied Bank West, Houston, Texas, and Allied Seabrook Bank, Seabrook, Texas, and Allied Spring Bank, Spring, Texas, and Allied Addicks Bank, Houston, Texas, and Allied Bank-Interstate 10, Houston, Texas, and Allied Bank of Texas, Houston, Texas, and Allied Beltway Bank, Houston, Texas, and Allied Deer Park Bank, Deer Park, Texas, and Allied Champions Bank, Harris County, Texas, and Allied Cypress Bank, Harris County, Texas, and Allied Fairbanks Bank, Houston, Texas, and Allied Bank-Gulf Freeway, Houston, Texas, and Allied Jetero Bank, Westfield, Texas, and Allied Bank Memorial, Houston, Texas, and Allied Mercantile Bank, Houston, Texas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Allied Bank North Belt, National Association, Houston, Texas (17612), with.....	\$ 57,002,000
and Allied Mission Bend Bank, Harris County, Texas, with.....	50,548,000
and Allied Bank Southwest Freeway, Houston, Texas, with.....	83,909,000
and Allied Bank West, Houston, Texas, with.....	410,412,000
and Allied Seabrook Bank, Seabrook, Texas, with.....	58,268,000
and Allied Spring Bank, Spring, Texas, with.....	109,995,000
and Allied Addicks Bank, Houston, Texas, with.....	84,362,000
and Allied Bank-Interstate 10, Houston, Texas, with.....	32,285,000
and Allied Bank of Texas, Houston, Texas, with.....	4,843,677,000
and Allied Beltway Bank, Houston, Texas, with.....	133,069,000
and Allied Deer Park Bank, Deer Park, Texas, with.....	105,514,000
and Allied Champions Bank, Harris County, Texas, with.....	292,239,000
and Allied Cypress Bank, Harris County, Texas, with.....	120,062,000
and Allied Fairbanks Bank, Houston, Texas, with.....	151,559,000
and Allied Bank-Gulf Freeway, Houston, Texas, with.....	31,234,000
and Allied Jetero Bank, Westfield, Texas, with.....	108,913,000
and Allied Bank Memorial, Houston, Texas, with.....	524,136,000
and Allied Mercantile Bank, Houston, Texas, with.....	326,691,000
merged February 1, 1988, under charter 17612 and title "Allied Bank, National Association." The merged bank at date of merger had.....	6,373,686,000

* * *

REPUBLIC NATIONAL BANK OF MIAMI,

Miami, Florida, and The Trust Bank, Hialeah, Florida

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Republic National Bank of Miami, Miami, Florida, (15555), with.....	\$ 997,000,000
and The Trust Bank, Hialeah, Florida, with.....	160,000,000
merged February 1, 1988, under charter and title of the former. The merged bank at date of merger had.....	1,157,000,000

* * *

PEOPLES NATIONAL BANK & TRUST,

Ottawa, Kansas, and Bank of Louisburg, Louisburg, Kansas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Peoples National Bank & Trust, Ottawa, Kansas (1910), with.....	\$ 47,302,000
and Bank of Louisburg, Louisburg, Kansas, with.....	20,672,000
merged February 3, 1988, under charter and title of the former. The merged bank at date of merger had.....	NA

* * *

PEOPLES NATIONAL BANK OF WASHINGTON, NATIONAL ASSOCIATION,

Seattle, Washington, and Old National Bank of Washington, Spokane, Washington

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Peoples National Bank of Washington, National Association, Seattle, Washington (14394), with.....	\$2,260,593,000
and Old National Bank of Washington, Spokane, Washington (4668), with.....	1,829,658,000
merged February 8, 1988, under charter of the former and title "U.S. Bank of Washington, National Association." The merged bank at date of merger had.....	4,117,012,000

* * *

THE AMERICAN NATIONAL BANK OF BRISTOW,
Bristow, Oklahoma, and First State Bank, Oilton, Oklahoma

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The American National Bank of Bristow, Bristow, Oklahoma (10849), with	\$ 73,572,000
and First State Bank Oilton Oklahoma, with	13,161,000
merged February 11, 1988, under charter and title of the former. The merged bank at date of merger had	NA

* * *

TEXAS COMMERCE BANK, NATIONAL ASSOCIATION,
Houston, Texas, and First Houston Bank, National Association, Houston, Texas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Texas Commerce Bank, National Association, Houston, Texas (10225), with	\$11,164,652,000
and First Houston Bank, National Association, Houston, Texas, (17992), with	33,175,000
merged February 11, 1988, under charter and title of the former. The merged bank at date of merger had	NA

* * *

THE FIRST NATIONAL BANK OF LAKE FOREST,
Lake Forest, Illinois, and First National Bank of Lake Bluff, Lake Bluff, Illinois, and Lake Forest National Bank,
Lake Forest, Illinois

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The First National Bank of Lake Forest, Lake Forest, Illinois (8937) with	\$395,130,000
and First National Bank of Lake Bluff, Lake Bluff, Illinois (15502), with	45,251,000
and Lake Forest National Bank, Lake Forest, Illinois (15886), with	23,461,000
merged February 15, 1988, under charter 8937 and title "Northern Trust Bank/Lake Forest, National Association." The merged bank at date of merger had	461,950,000

* * *

ZIONS FIRST NATIONAL BANK,
Salt Lake City, Utah, and Basin State Bank, Vernal, Utah

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Zions First National Bank, Salt Lake City, Utah (4341), with	\$2,564,248,000
and Basin State Bank, Vernal, Utah, with	11,982,000
merged February 16, 1988, under charter and title of the former. The merged bank at date of merger had	NA

* * *

THE FIRST NATIONAL BANK OF MOORE,
Moore, Oklahoma, and Mustang Community Bank, Mustang, Oklahoma

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The First National Bank of Moore, Moore, Oklahoma (12035), with	\$ 44,078,000
and Mustang Community Bank, Mustang, Oklahoma, with	9,407,000
merged February 18, 1988, under charter and title of the former. The merged bank at date of merger had	NA

* * *

VALLEY BANK OF WATERTOWN, NATIONAL ASSOCIATION,
Watertown, Wisconsin, and Valley Bank of Juneau, Juneau, Wisconsin

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Valley Bank of Watertown, National Association, Watertown, Wisconsin (14064), with	\$ 37,742,000
and Valley Bank of Juneau, Juneau, Wisconsin, with	20,872,000
merged February 22, 1988, under charter and title of the former. The merged bank at date of merger had	58,614,000

* * *

OMNIBANC SOUTH, NATIONAL ASSOCIATION,
Houston, Texas, and Harris County Bank, Houston, National Association, Houston, Texas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
OmniBanc South, National Association, Houston, Texas (14703), with	\$ 55,387,000
and Harris County Bank, Houston, National Association, Houston, Texas (15832), with	80,724,000
merged February 25, 1988, under charter and title of the former. The merged bank at date of merger had	NA

* * *

PARK NATIONAL BANK OF HOUSTON,
Houston, Texas, and American National Bank, Stafford, Texas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Park National Bank of Houston, Texas (18349), with	\$ 30,594,000
and American National Bank, Stafford, Texas (17377), with	31,314,000
merged February 25, 1988, under charter and title of the former. The merged bank at date of merger had	NA

* * *

WILLOW BEND NATIONAL BANK,
Plano, Texas, and Collin County State Bank, Melissa, Texas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Willow Bend National Bank, Plano, Texas (17894), with	\$ 63,134,000
and Collin County State Bank, Melissa, Texas, with	12,451,000
merged February 25, 1988, under charter and title of the former. The merged bank at date of merger had	NA

* * *

FIRST NATIONAL BANK,
Iola, Wisconsin, and First National Bank of Waupaca, Waupaca, Wisconsin

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
First National Bank, Iola, Washington (21610), with	\$ 23,587,000
and First National Bank of Waupaca, Waupaca, Wisconsin (14063), with	44,720,000
merged February 26, 1988, under charter 21610 and title "First National Bank" in Waupaca. The merged bank at date of merger had	68,307,000

* * *

BANK ONE, AKRON, NATIONAL ASSOCIATION,
Akron, Ohio, and Bank One, Alliance, National Association, Alliance, Ohio

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Bank One, Akron, National Association, Akron, Ohio (17008), with	\$ 1,098,526,000
and Bank One, Alliance, National Association, Alliance, Ohio (3721), with	176,240,000
merged March 1, 1988, under charter and title of the former. The merged bank at date of merger had	1,274,766,000

* * *

CHASE BANK OF FLORIDA, NATIONAL ASSOCIATION,
St. Petersburg, Florida, and The Chase Manhattan Trust Company of Florida, National Association, Palm Beach, Florida

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Chase Bank of Florida, National Association, St. Petersburg, Florida (21177), with	\$ 379,942,000
and The Chase Manhattan Trust Company of Florida, National Association, Palm Beach, Florida (17674), with	2,455,000
merged March 1, 1988, under charter and title of the former. The merged bank at date of merger had	382,397,000

* * *

THE FIRST NATIONAL BANK & TRUST COMPANY OF SALINA,
Salina, Kansas, and The Home State Bank, Russell, Kansas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The First National Bank & Trust Company of Salina, Salina, Kansas (4742), with	\$ 135,408,000
and The Home State Bank, Russell, Kansas, with	59,884,000
merged March 3, 1988, under charter and title of the former. The merged bank at date of merger had	NA

* * *

MBANK ALAMO, NATIONAL ASSOCIATION,
San Antonio, Texas, and MBank San Antonio North, National Association, San Antonio, Texas, and MBank
San Antonio South, National Association, San Antonio, Texas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
MBank Alamo, National Association, San Antonio, Texas (4525), with	\$ 1,014,308,000
and MBank San Antonio North, National Association, San Antonio, Texas (17649), with	37,619,000
and MBank San Antonio South, National Association, San Antonio, Texas (16740), with	24,364,000
merged March 4, 1988, under charter and title of MBank Alamo, National Association. The merged bank at date of merger had	1,076,291,000

* * *

THE AMERICAN NATIONAL BANK OF BRISTOW,
Bristow, Oklahoma, and The First National Bank and Trust Company of Cushing, Cushing, Oklahoma

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The American National Bank of Bristow, Bristow, Oklahoma (10849), with	\$ 73,572,000
and The First National Bank and Trust Company of Cushing, Cushing, Oklahoma (6893), with	13,161,000
merged March 10, 1988, under charter and title of the former. The merged bank at date of merger had	NA

* * *

CITY CENTER NATIONAL BANK,
Aurora, Colorado, and Security Bank of Denver, National Association, Denver, Colorado

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
City Center National Bank, Aurora, Colorado (17584), with	\$ 4,718,000
and Security Bank of Denver, National Association, Denver, Colorado (15009), with	16,987,000
merged March 10, 1988, under charter and title of the former. The merged bank at date of merger had	NA

* * *

FIRST NATIONAL BANK OF ALVIN,
Alvin, Texas, and First American Bank and Trust of Manvel, Manvel, Texas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
First National Bank of Alvin, Alvin, Texas (14905), with	\$ 56,660,000
and First American Bank and Trust of Manvel, Manvel, Texas, with	12,268,000
merged March 10, 1988, under charter and title of the former. The merged bank at date of merger had	NA

* * *

COMMUNITY NATIONAL BANK AND TRUST COMPANY OF NEW YORK,
Staten Island, New York, and First Inter-County Bank of New York, New York, New York

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Community National Bank and Trust Company of New York, Staten Island, New York (15558), with	\$ 171,955,000
and First Inter-County Bank of New York, New York, New York, with	34,800,000
merged March 11, 1988, under charter and title of the former. The merged bank at date of merger had	206,755,000

* * *

THE MOODY NATIONAL BANK OF GALVESTON,
Galveston, Texas, and South Shore National Bank, League City, Texas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The Moody National Bank of Galveston, Galveston, Texas (8899), with	\$ 130,000,000
and South Shore National Bank, League City, Texas (20002), with	8,500,000
merged March 11, 1988, under charter and title of the former. The merged bank at date of merger had	135,840,000

* * *

SHAWMUT BANK OF SOUTHEASTERN MASSACHUSETTS, NATIONAL ASSOCIATION,
New Bedford, Massachusetts, and Shawmut Bank of Cape Cod, National Association, Orleans,
Massachusetts

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Shawmut Bank of Southeastern Massachusetts, National Association, New Bedford, Massachusetts (261), with	\$ 284,285,000
and Shawmut Bank of Cape Cod, National Association, Orleans, Massachusetts (736), with	121,689,000
merged March 11, 1988, under charter and title of the former. The merged bank at date of merger had	405,894,000

* * *

THE FIRST NATIONAL BANK OF SPRINGFIELD,
Springfield, Illinois, and Land of Lincoln Bank, Springfield, Illinois

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The First National Bank of Springfield, Springfield, Illinois (205), with	\$ 334,605,000
and Land of Lincoln Bank, Springfield, Illinois, with	65,275,000
merged March 12, 1988, under charter and title of the former. The merged bank at date of merger had	399,880,000

* * *

THE GETTYSBURG NATIONAL BANK,
Gettysburg, Pennsylvania, and Community National Bank of Southern Pennsylvania, Littlestown, Pennsylvania

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The Gettysburg National Bank, Gettysburg, Pennsylvania (611), with	\$ 173,500,000
and Community National Bank of Southern Pennsylvania, Littlestown, Pennsylvania (9207), with	62,000,000
merged March 16, 1988, under charter and title of the former. The merged bank at date of merger had	235,500,000

COMPTROLLER'S DECISION

On September 30, 1987, application was made to the Office of the Comptroller of the Currency for prior authorization to merge Community National Bank of Southern Pennsylvania, Littlestown, Pennsylvania (CNB-Southern) with and into The Gettysburg National Bank, Gettysburg, Pennsylvania (GNB). An Agreement and Plan of Reorganization was finalized between the proponents on November 19, 1987.

As of September 30, 1987, CNB-Southern had total deposits of \$57 million in six offices. CNB-Southern is

wholly owned by a one-bank holding company. As of the same date, GNB held total deposits of \$172 million in 6 offices. GNB is a subsidiary of CCNB Corp., a multi-bank holding company.

The relevant geographic market for this proposal is comprised of Adams County and adjacent portions of York County, Pennsylvania, including the city of Hanover. The two banks compete directly within this market and all offices of both CNB-Southern and GNB are located within the market area. In addition, one branch of GNB's affiliate,

CCNB Bank National Association is situated within the geographic market area. In this market, aggregate deposits of CCNB Corp subsidiary banks rank third among twelve banks and thrift institutions, with 15 percent of market deposits. CNB-Southern ranks sixth, with a 5 percent market share. The resulting bank would be a subsidiary of CCNB Corp., which would then hold 20 percent of aggregate deposits and rank third in the market.

The market contains two institutions with small market shares, which are subsidiaries of multi-billion dollar, multi-bank holding companies. These banks could bring considerable additional presence to bear in the market. Within this geographic market, the number and size of remaining competitors would prevent this proposal from having any significant adverse effect on competition.

The Bank Merger Act requires this Office to consider "the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served." We find that the financial and managerial resources of CNB-Southern and GNB are satisfactory. The future prospects of the proponents, individually and

combined, are considered favorable and the resulting bank is expected to meet the convenience and needs of the community to be served.

A review of the record of this application and other information available to this Office as a result of its regulatory responsibilities revealed no evidence that the applicants' records of helping to meet the credit needs of their communities, including low and moderate income neighborhoods, are less than satisfactory.

We have analyzed this proposal pursuant to the Bank Merger Act, 12 U.S.C. 1828(c), and find that it will not significantly lessen competition in the relevant market. Other factors considered in evaluating this proposal are satisfactory. Accordingly, the application is approved.

February 2, 1988

SUMMARY OF REPORT BY ATTORNEY GENERAL

We have reviewed this proposed transaction and conclude that it would not have a significantly adverse effect on competition.

* * *

LIBERTY NATIONAL BANK AND TRUST COMPANY OF INDIANA,
Corydon, Indiana, and First Indiana Bank, National Association, Milltown, Indiana

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Liberty National Bank and Trust Company of Indiana, Corydon, Indiana (21327), with.....	\$ 70,352,000
and First Indiana Bank, National Association, Milltown, Indiana (8650), with.....	6,740,000
merged March 17, 1988, under charter and title of the former. The merged bank at date of merger had.....	77,611,000

* * *

THE CONNECTICUT NATIONAL BANK,
Hartford, Connecticut, and Shawmut Fidelity Bank, Stamford, Connecticut, and Shawmut Home Bank,
Meriden, Connecticut

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The Connecticut National Bank, Hartford, Connecticut (1338), with.....	\$ 8,772,736,000
and Shawmut Fidelity Bank, Stamford, Connecticut, with.....	273,309,000
and Shawmut Home Bank, Meriden, Connecticut, with.....	480,129,000
merged March 18, 1988, under charter and title of The Connecticut National Bank. The merged bank at date of merger had.....	9,526,174,000

* * *

THE FROST NATIONAL BANK OF SAN ANTONIO,
San Antonio, Texas, and Citizens Frost Bank, National Association, San Antonio, Texas, and Colonial Frost Bank, National Association, San Antonio, Texas, and Liberty Frost Bank, National Association, San Antonio, Texas, and North Frost Bank, National Association, San Antonio, Texas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The Frost National Bank of San Antonio, San Antonio, Texas (5179), with.....	\$ 2,008,000,000
and Citizens Frost Bank, National Association, San Antonio, Texas (14938), with.....	119,000,000
and Colonial Frost Bank, National Association, San Antonio, Texas (16336), with.....	95,000,000
and Liberty Frost Bank, National Association, San Antonio, Texas (16314), with.....	73,000,000
and North Frost Bank, National Association, San Antonio, Texas (17145), with.....	117,000,000
merged March 18, 1988, under charter and title of The Frost National Bank of San Antonio. The merged bank at date of merger had.....	2,379,000,000

* * *

NORTHERN TRUST BANK/O'HARE, NATIONAL ASSOCIATION,
Chicago, Illinois, and Northern Trust Bank/Woodfield, Schaumburg, Illinois

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Northern Trust Bank/O'Hare, National Association, Chicago, Illinois (14888), with.....	\$ 348,599,000
and Northern Trust Bank/Woodfield, Schaumburg, Illinois, with.....	70,845,000
merged March 21, 1988, under charter and title of the former. The merged bank at date of merger had.....	419,444,000

* * *

THE FOURTH NATIONAL BANK OF TULSA,
Tulsa, Oklahoma, and Century Bank, Tulsa, Oklahoma

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The Fourth National Bank of Tulsa, Tulsa, Oklahoma (13480), with.....	\$ 419,846,000
and Century Bank, Tulsa, Oklahoma, with.....	70,834,000
merged March 24, 1988, under charter and title of the former. The merged bank at date of merger had.....	NA

* * *

BANK OF BOSTON-FLORIDA, NATIONAL ASSOCIATION,
Palm Beach, Florida, and First Trust Company of Florida, National Association, Sarasota, Florida

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Bank of Boston-Florida, National Association, Palm Beach, Florida (17277), with.....	\$ 220,000,000
and First Trust Company of Florida, National Association, Sarasota, Florida (17441), with.....	80,000,000
merged March 25, 1988, under charter of the former and title of the former. The merged bank at date of merger had.....	300,000,000

COMPTROLLER'S DECISION

On September 2, 1987, application was made to the Office of the Comptroller of the Currency pursuant to the Bank Merger Act, 12 U.S.C. 1828(c), for prior authorization to merge First Trust Company of Florida, National Association, Sarasota, Florida (FTC), into Bank of Boston-Florida, National Association, Palm Beach, Florida (BB-F). The application is based on an agreement finalized between FTC and BB-F on September 9, 1987.

FTC, a wholly owned subsidiary of First Bank Systems, Inc., has no deposits and total trust assets of approximately \$80 million as of June 30, 1987.

BB-F, a wholly owned subsidiary (as of March 1, 1987) of RIHT Financial Corporation, has minimal deposits and total trust assets of \$220 million as of June 30, 1987.

The relevant geographic market for this proposal is considered to be the City of Sarasota, where FTC's only office is located. There are nine other institutions offering trust services in the City of Sarasota in addition to the two applicants. Subsequent to the merger, there will continue to be ten institutions offering fiduciary services to the market. In addition, many other institutions which are not located in the market effectively compete for trust assets.

serving longtime customers who have relocated to the Sarasota market. The merger will enable the resulting institution to become a stronger competitor and will not have an adverse effect on competition in the Sarasota market.

The Bank Merger Act requires this Office to consider "the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served." We find that the financial and managerial resources of both banks do not raise concerns that would cause the application to be disapproved. The future prospects of the resulting bank are considered satisfactory, as are the effects of the proposal on the convenience and needs of the community to be served.

A review of the record of this application and other information available to this Office as a result of its regu-

latory responsibilities revealed no evidence that the applicants' records of helping to meet the credit needs of their communities, including low and moderate income neighborhoods, are less than satisfactory.

We have analyzed this proposal pursuant to the Bank Merger Act, 12 U.S.C. 1828(c), and find that it will not significantly lessen competition in the relevant market. Other factors considered in evaluating this proposal are satisfactory. Accordingly, the application is approved.

February 19, 1988

SUMMARY OF REPORT BY ATTORNEY GENERAL

We have reviewed this proposed transaction and conclude that it would not have a significantly adverse effect on competition.

* * *

LINCOLN NATIONAL BANK,
Oklahoma City, Oklahoma, and First National Bank of Del City, Del City, Oklahoma

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Lincoln National Bank, Oklahoma City, Oklahoma (18596), with	\$ 13,127,000
and First National Bank of Del City, Del City, Oklahoma (18110), with	30,860,000
merged March 25, 1988, under charter and title of the former. The merged bank at date of merger had	NA

* * *

MERCANTILE BANK, NATIONAL ASSOCIATION,
Clayton, Missouri, and Mercantile Bank of St. Charles County, National Association, St. Charles, Missouri

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Mercantile Bank, National Association, Clayton, Missouri (21073), with	\$ 4,363,928,000
and Mercantile Bank of St. Charles County, National Association, St. Charles, Missouri (21684), with	74,470,000
merged March 25, 1988, under charter of the former and title of the latter. The merged bank at date of merger had . .	4,434,250,000

* * *

CENTERRE BANK OF SOUTH KANSAS CITY, NATIONAL ASSOCIATION,
Kansas City, Missouri, and Centerre Bank of Kansas City, National Association, Kansas City, Missouri

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
Centerre Bank of South Kansas City, National Association, Kansas City, Missouri (21523), with	\$ 113,893,000
and Centerre Bank of Kansas City, National Association, Kansas City, Missouri (11472), with	608,350,000
merged March 31, 1988, under charter of the former and title of the latter. The merged bank at date of merger had . .	722,237,000

* * *

FIRST MIDWEST BANK/MOLINE, A NATIONAL ASSOCIATION,
Moline, Illinois, and First Midwest Bank/Knox City, National Association, Galesburg, Illinois

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
First Midwest Bank/Moline, A National Association, Moline, Illinois (13660), with.....	\$ 164,131,000
and First Midwest Bank/Knox County, National Association, Galesburg, Illinois (3287), with.....	84,534,000
merged March 31, 1988, under charter of the former and title "First Midwest Bank/Western Illinois, National Association." The merged bank at date of merger had.....	248,665,000

* * *

FIRST NATIONAL BANK OF ALICEVILLE,
Aliceville, Alabama, and Bank of Gordo, Gordo, Alabama

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
First National Bank of Aliceville, Aliceville, Alabama (15535), with.....	\$ 23,283,000
and Bank of Gordo, Gordo, Alabama, with.....	22,318,000
merged March 31, 1988, under charter and title of the former. The merged bank at date of merger had.....	45,601,000

* * *

THE FIRST NATIONAL BANK OF ATLANTA,
Atlanta, Georgia, and North Georgia Bank, Canton, Georgia

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The First National Bank of Atlanta, Atlanta, Georgia (1559), with.....	\$ 7,179,165,000
and North Georgia Bank, Canton, Georgia, with.....	59,238,000
merged March 31, 1988, under charter and title of the former. The merged bank at date of merger had.....	7,238,403,000

* * *

THE HAMILTON NATIONAL BANK,
Hamilton, Texas, and First Bank & Trust, Tomball, Texas

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
The Hamilton National Bank, Hamilton, Texas (4451), with.....	\$ 46,972,000
and First Bank & Trust, Tomball, Texas, with.....	68,665,000
merged March 31, 1988, under charter and title of the former. The merged bank at date of merger had.....	NA

* * *

NATIONAL BANK OF DETROIT,
Detroit, Michigan, and Pontiac State Bank, Pontiac, Michigan

<i>Names of banks and type of transaction</i>	<i>Total assets</i>
National Bank of Detroit, Detroit, Michigan (13671), with.....	\$14,775,028,000
and Pontiac State Bank, Pontiac, Michigan, with.....	678,127,000
merged March 31, 1988, under charter and title of the former. The merged bank at date of merger had.....	15,453,155,000

* * *

Statistical Tables

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NOTE: The statistical tables were produced by the Information Systems and Technology Division.

Assets, liabilities and capital accounts of national banks, December 31, 1986, and December 31, 1987
(Dollar amounts in millions)

	Dec 31, 1986 4,862 banks	Dec 31, 1987 4,623 banks*	Change Dec 31 1986 Dec 31 1987 Fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
Assets				
Cash and balances due from depository institutions:				
Noninterest-bearing balances and currency and coin	\$ 139,911	\$ 123,444	\$-16,467	-11.8
Interest-bearing balances	88,379	91,764	3,385	3.8
Securities	277,460	289,629	12,169	4.4
Federal funds sold and securities purchased under agreements to resell	78,862	76,671	-2,191	-2.8
Loans and leases, net of unearned income	1,075,273	1,115,506	40,233	3.7
Less allowance for loan and lease losses	18,045	31,969	13,924	77.2
Less allocated transfer risk reserve	92	136	44	47.8
Net loans and leases	1,057,136	1,083,401	26,265	2.5
Premises and fixed assets	25,573	26,807	1,234	4.8
Other real estate owned	4,962	6,282	1,320	26.6
Other assets	71,001	76,565	5,564	7.8
Total assets	1,743,283	1,774,563	31,280	1.8
Liabilities				
Noninterest-bearing deposits in domestic offices	308,914	278,035	-30,879	-10.0
Interest-bearing deposits in domestic offices	816,897	861,641	44,744	5.5
Total domestic deposits	1,125,811	1,139,677	13,866	1.2
Noninterest-bearing deposits in foreign offices	9,648	10,318	670	6.9
Interest-bearing deposits in foreign offices	186,755	200,688	13,933	7.5
Total foreign deposits	196,403	211,006	14,603	7.4
Total deposits	1,322,214	1,350,683	28,469	2.2
Federal funds purchased and securities sold under agreements to repurchase	173,132	164,917	-8,215	-4.7
Interest-bearing demand notes issued to the U.S. Treasury	15,943	12,921	-3,022	-19.0
Other liabilities for borrowed money	52,874	65,026	12,152	23.0
Mortgage indebtedness and liability for capitalized leases	1,605	1,482	-123	-7.7
Subordinated notes and debentures	9,830	9,743	-87	-0.9
All other liabilities	65,049	69,046	3,997	6.1
Total liabilities	1,640,646	1,673,818	33,172	2.0
Limited-life preferred stock	74	77	3	4.1
Equity capital				
Perpetual preferred stock	811	943	132	16.3
Common stock	16,443	16,694	251	1.5
Surplus	32,765	37,269	4,504	13.7
Undivided profits and capital reserves	52,847	46,063	-6,784	-12.8
Cumulative foreign currency translation adjustments	-304	-300	4	-1.3
Total equity capital	102,563	100,669	-1,894	-1.8
Total liabilities, limited-life preferred stock, and equity capital	1,743,283	1,774,564	31,281	1.8

* Reporting national banks. Does not include the nonnational bank in the District of Columbia

Consolidated foreign and domestic assets, liabilities and capital accounts of national banks, by states, December 31, 1987
(Dollar amounts in millions)

	Total United States	Alabama	Alaska	Arizona	Arkansas	California	Colorado
Assets							
Cash and balances due from depository institutions							
Noninterest-bearing balances and currency and coin							
Interest-bearing balances							
Securities							
Federal funds sold and securities purchased under agreements to resell							
Loans and leases, net of unearned income							
Less allowance for loan and lease losses							
Less allocated transfer risk reserve							
Net loans and leases							
Premises and fixed assets							
Other real estate owned							
Other assets							
Total assets							
Liabilities							
Noninterest-bearing deposits in domestic offices							
Interest-bearing deposits in domestic offices							
Total domestic deposits							
Noninterest-bearing deposits in foreign offices							
Interest-bearing deposits in foreign offices							
Total foreign deposits							
Total deposits							
Federal funds purchased and securities sold under agreements to repurchase							
Interest-bearing demand notes issued to the U.S. Treasury							
Other liabilities for borrowed money							
Mortgage indebtedness and liability for capitalized leases							
Subordinated notes and debentures							
All other liabilities							
Total liabilities							
Limited-life preferred stock							
Equity capital							
Perpetual preferred stock							
Common stock							
Surplus							
Undivided profits and capital reserves							
Cumulative foreign currency translation adjustments							
Total equity capital							
Total liabilities, limited-life preferred stock, and equity capital							
Number of banks with foreign offices							

See notes at end of table.

Consolidated foreign and domestic assets, liabilities and capital accounts of national banks, by states, December 31, 1987—continued
(Dollar amounts in millions)

	Connecticut	Delaware	Dist. of Col.	Florida	Georgia	Hawaii	Idaho
Number of banks	17	17	20	161	55	3	6
Assets							
Cash and balances due from depository institutions:							
Noninterest-bearing balances and currency and coin	\$ 1,794	\$ 288	\$ 1,088	\$ 6,722	\$ 2,835	\$ 21	\$ 417
Interest-bearing balances	533	43	2,188	1,303	1,080	—	335
Securities	3,538	485	2,807	16,402	5,771	59	1,109
Federal funds sold and securities purchased under agreements to resell	931	72	653	3,417	943	20	161
Loans and leases, net of unearned income	13,609	17,344	10,856	49,625	21,920	133	3,443
Less allowance for loan and lease losses	162	535	215	729	339	2	73
Less allocated transfer risk reserve	2	0	0	—	0	0	0
Net loans and leases	13,446	16,808	10,640	48,896	21,581	131	3,370
Premises and fixed assets	316	136	265	1,732	623	3	86
Other real estate owned	30	1	20	147	40	—	17
Other assets	425	541	650	1,936	1,098	3	95
Total assets	21,013	18,374	18,312	80,554	33,972	239	5,590
Liabilities							
Noninterest-bearing deposits in domestic offices	4,786	346	2,889	14,495	7,239	50	807
Interest-bearing deposits in domestic offices	10,131	6,194	8,860	49,647	17,393	168	3,675
Total domestic deposits	14,917	6,540	11,749	64,142	24,632	218	4,481
Noninterest-bearing deposits in foreign offices	0	0	7	6	57	0	0
Interest-bearing deposits in foreign offices	919	0	2,646	795	687	0	0
Total foreign deposits	919	0	2,653	801	744	0	0
Total deposits	15,835	6,540	14,402	64,943	25,377	218	4,481
Federal funds purchased and securities sold under agreements to repurchase							
Interest-bearing demand notes issued to the U.S. Treasury	3,173	3,952	1,949	8,558	4,700	1	567
Other liabilities for borrowed money	261	2	198	439	13	1	55
Mortgage indebtedness and liability for capitalized leases	83	5,849	191	228	217	0	2
Subordinated notes and debentures	19	2	10	60	26	0	3
All other liabilities	156	140	126	234	246	2	16
	300	536	505	1,205	1,264	2	88
Total liabilities	19,827	17,022	17,381	75,667	31,843	223	5,213
Limited-life preferred stock	0	0	0	0	0	0	0
Equity capital							
Perpetual preferred stock	9	13	0	1	1	—	0
Common stock	116	189	83	710	212	7	43
Surplus	377	545	201	2,047	750	4	192
Undivided profits and capital reserves	685	605	649	2,129	1,166	4	142
Cumulative foreign currency translation adjustments	—	0	-1	0	0	0	0
Total equity capital	1,186	1,352	931	4,887	2,129	15	376
Total liabilities, limited-life preferred stock, and equity capital	21,013	18,374	18,312	80,554	33,972	239	5,590
Number of banks with foreign offices	2	1	6	14	3	0	0

See notes at end of table

Consolidated foreign and domestic assets, liabilities and capital accounts of national banks, by states, December 31, 1987—continued
(Dollar amounts in millions)

	Illinois	Indiana	Iowa	Kansas	Kentucky	Louisiana	Madison
Number of banks	387	102	103	167	79	65	7
Assets							
Cash and balances due from depository institutions:							
Noninterest-bearing balances and currency and coin	\$ 7,032	\$ 2,435	\$ 805	\$ 870	\$ 1,134	\$ 1,464	\$ 253
Interest-bearing balances	10,681	961	112	138	255	399	10
Securities	18,704	6,381	2,896	3,385	3,020	5,182	384
Federal funds sold and securities purchased under agreements to resell	3,664	1,087	752	821	774	973	65
Loans and leases, net of unearned income	68,596	16,969	4,664	5,368	8,444	11,653	2,338
Less allowance for loan and lease losses	2,877	260	88	96	124	258	27
Less allocated transfer risk reserve	0	0	0	0	0	0	0
Net loans and leases	65,719	16,709	4,575	5,272	8,321	11,395	2,311
Premises and fixed assets	1,270	331	132	166	207	500	45
Other real estate owned	123	43	39	49	32	216	1
Other assets	5,991	635	188	197	229	389	29
Total assets	113,184	28,583	9,500	10,898	13,972	20,519	3,099
Liabilities							
Noninterest-bearing deposits in domestic offices	15,106	5,027	1,778	1,854	2,357	4,012	538
Interest-bearing deposits in domestic offices	45,411	17,536	6,238	7,437	8,535	12,976	2,113
Total domestic deposits	60,517	22,563	8,015	9,291	10,893	16,988	2,651
Noninterest-bearing deposits in foreign offices	495	0	0	0	7	0	0
Interest-bearing deposits in foreign offices	25,443	372	0	0	163	208	0
Total foreign deposits	25,938	372	0	0	170	208	0
Total deposits	86,455	22,934	8,015	9,291	11,063	17,196	2,651
Federal funds purchased and securities sold under agreements to repurchase	8,674	2,884	623	556	1,498	1,501	150
Interest-bearing demand notes issued to the U.S. Treasury	1,379	243	48	59	138	24	11
Other liabilities for borrowed money	5,682	86	2	9	61	31	72
Mortgage indebtedness and liability for capitalized leases	30	29	15	7	22	34	2
Subordinated notes and debentures	468	11	19	4	2	131	—
All other liabilities	4,739	439	112	117	169	220	22
Total liabilities	107,427	26,626	8,835	10,044	12,952	19,138	2,907
Limited-life preferred stock	0	0	0	0	0	0	0
Equity capital							
Perpetual preferred stock	11	—	13	—	1	0	0
Common stock	1,940	230	106	138	105	176	30
Surplus	2,404	531	169	219	170	508	46
Undivided profits and capital reserves	1,433	1,196	378	496	744	697	116
Cumulative foreign currency translation adjustments	-32	0	0	0	0	0	0
Total equity capital	5,757	1,957	665	854	1,019	1,381	192
Total liabilities, limited-life preferred stock, and equity capital	113,184	28,583	9,500	10,898	13,972	20,519	3,099
Number of banks with foreign offices	5	3	1	0	2	2	0

See notes at end of table

Consolidated foreign and domestic assets, liabilities and capital accounts of national banks, by states, December 31, 1987—continued
(Dollar amounts in millions)

	Maryland	Massachusetts	Michigan	Minnesota	Mississippi	Missouri	Montana
Number of banks	26	41	92	198	28	99	60
Assets							
Cash and balances due from depository institutions:							
Noninterest-bearing balances and currency and coin	\$ 1,637	\$ 3,381	\$ 3,460	\$ 3,223	\$ 571	\$ 3,619	\$ 227
Interest-bearing balances	558	2,060	3,291	2,527	158	551	71
Securities	4,954	7,111	8,261	9,164	2,344	5,227	901
Federal funds sold and securities purchased under agreements to resell	730	1,071	1,850	2,608	433	1,957	1,025
Loans and leases, net of unearned income	14,299	39,710	25,519	21,224	4,761	15,274	1,827
Less allowance for loan and lease losses	244	1,117	434	665	78	356	50
Less allocated transfer risk reserve	2	3	0	0	0	0	0
Net loans and leases	14,052	38,591	25,086	20,558	4,684	14,918	1,777
Premises and fixed assets	256	692	516	300	176	517	62
Other real estate owned	13	78	68	90	35	52	20
Other assets	931	2,289	1,368	2,083	183	441	87
Total assets	23,132	55,272	43,899	40,553	8,584	27,282	4,171
Liabilities							
Noninterest-bearing deposits in domestic offices	3,987	8,401	7,582	6,217	1,406	6,375	771
Interest-bearing deposits in domestic offices	11,308	22,138	25,020	19,975	5,864	14,983	2,673
Total domestic deposits	15,295	30,539	32,602	26,192	7,271	21,358	3,443
Noninterest-bearing deposits in foreign offices	—	393	35	31	0	0	0
Interest-bearing deposits in foreign offices	1,402	8,167	2,530	2,608	0	363	0
Total foreign deposits	1,402	8,560	2,565	2,639	0	363	0
Total deposits	16,697	39,099	35,167	28,831	7,271	21,721	3,443
Federal funds purchased and securities sold under agreements to repurchase	2,950	9,000	3,865	5,992	541	2,869	370
Interest-bearing demand notes issued to the U.S. Treasury	237	684	431	369	6	237	12
Other liabilities for borrowed money	675	2,033	299	994	49	207	14
Mortgage indebtedness and liability for capitalized leases	26	28	24	33	4	83	7
Subordinated notes and debentures	170	230	155	282	4	—	10
All other liabilities	973	1,497	1,358	1,800	85	346	57
Total liabilities	21,729	52,571	41,298	38,302	7,960	25,462	3,913
Limited-life preferred stock	0	0	0	0	0	0	0
Equity capital							
Perpetual preferred stock	4	4	0	63	0	4	6
Common stock	103	151	351	391	49	264	91
Surplus	505	1,026	796	709	495	465	97
Undivided profits and capital reserves	792	1,520	1,448	1,088	79	1,087	65
Cumulative foreign currency translation adjustments	0	1	6	—	0	0	0
Total equity capital	1,403	2,701	2,601	2,251	624	1,820	258
Total liabilities, limited-life preferred stock, and equity capital	23,132	55,272	43,899	40,553	8,584	27,282	4,171
Number of banks with foreign offices	3	4	4	3	0	4	0

See notes at end of table

Consolidated foreign and domestic assets, liabilities and capital accounts of national banks, by states, December 31, 1987—continued
(Dollar amounts in millions)

	Nebraska	Nevada	New Hampshire	New Jersey	New Mexico	New York	North Carolina
Number of banks	115	7	20	67	42	103	1
Assets							
Cash and balances due from depository institutions	\$ 840	\$ 458	\$ 256	\$ 4,597	\$ 441	\$ 16,886	\$ 3,280
Noninterest-bearing balances and currency and coin	77	98	14	609	53	32,133	2,249
Interest-bearing balances	3,112	865	530	9,801	1,425	38,150	11,351
Securities	454	69	145	1,218	490	12,249	1,053
Federal funds sold and securities purchased under agreements to resell							
Loans and leases, net of unearned income	4,919	5,534	3,662	37,716	3,286	192,805	28,769
Less allowance for loan and lease losses	97	136	37	556	45	7,573	432
Less allocated transfer risk reserve	0	0	0	0	0	1	0
Net loans and leases	4,822	5,398	3,624	37,161	3,242	185,231	28,336
Premises and fixed assets	162	128	53	778	120	4,300	718
Other real estate owned	41	27	6	23	39	249	33
Other assets	207	124	104	1,350	105	27,664	1,986
Total assets	9,715	7,166	4,733	55,538	5,915	316,863	49,006
Liabilities							
Noninterest-bearing deposits in domestic offices	1,702	977	599	12,415	919	36,668	6,855
Interest-bearing deposits in domestic offices	6,505	2,678	3,202	32,464	4,047	79,686	22,523
Total domestic deposits	8,208	3,655	3,801	44,879	4,966	116,354	29,379
Noninterest-bearing deposits in foreign offices	0	0	0	1	0	7,084	12
Interest-bearing deposits in foreign offices	0	0	0	311	0	106,547	2,841
Total foreign deposits	0	0	0	312	0	113,631	2,853
Total deposits	8,208	3,655	3,801	45,191	4,966	229,985	32,232
Federal funds purchased and securities sold under agreements to repurchase	481	534	240	5,056	433	17,039	11,417
Interest-bearing demand notes issued to the U.S. Treasury	25	14	18	178	15	1,560	385
Other liabilities for borrowed money	76	1,908	303	565	3	21,440	356
Mortgage indebtedness and liability for capitalized leases	27	4	14	25	3	164	75
Subordinated notes and debentures	7	150	—	157	7	1,594	141
All other liabilities	128	237	63	1,049	53	29,230	1,581
Total liabilities	8,951	6,503	4,439	52,221	5,480	301,013	46,186
Limited-life preferred stock	0	0	0	0	0	0	67
Equity capital							
Perpetual preferred stock	1	0	0	7	0	110	0
Common stock	108	133	12	566	95	2,427	341
Surplus	164	258	100	763	136	7,481	571
Undivided profits and capital reserves	492	273	182	1,980	204	6,024	1,842
Cumulative foreign currency translation adjustments	0	0	0	0	0	-191	-2
Total equity capital	765	663	294	3,316	434	15,850	2,753
Total liabilities, limited-life preferred stock, and equity capital	9,715	7,166	4,733	55,538	5,915	316,863	49,006
Number of banks with foreign offices	0	0	0	6	0	9	3

See notes at end of table

Consolidated foreign and domestic assets, liabilities and capital accounts of national banks, by states, December 31, 1987—continued
(Dollar amounts in millions)

	North Dakota	Ohio	Oklahoma	Oregon	Pennsylvania	Rhode Island	South Carolina
Number of banks	41	139	206	8	169	5	22
Assets							
Cash and balances due from depository institutions:							
Noninterest-bearing balances and currency and coin	\$ 244	\$ 4,848	\$ 1,314	\$ 1,239	\$ 6,655	\$ 562	\$ 983
Interest-bearing balances	61	2,738	391	403	7,328	281	30
Securities	824	12,774	5,276	2,525	19,982	1,983	2,102
Federal funds sold and securities purchased under agreements to resell	464	2,773	1,032	632	3,074	112	560
Loans and leases, net of unearned income	1,538	46,252	7,915	8,851	60,813	8,283	7,269
Less allowance for loan and lease losses	34	770	275	151	1,934	190	90
Less allocated transfer risk reserve	0	0	0	0	0	0	0
Net loans and leases	1,504	45,481	7,641	8,700	58,879	8,093	7,179
Premises and fixed assets	39	1,003	297	169	1,175	118	193
Other real estate owned	9	54	251	34	213	17	17
Other assets	58	1,800	373	543	5,107	722	220
Total assets	3,203	71,472	16,574	14,245	102,412	11,888	11,284
Liabilities							
Noninterest-bearing deposits in domestic offices	510	10,619	3,024	2,304	15,207	1,276	2,230
Interest-bearing deposits in domestic offices	2,246	43,915	11,118	8,650	52,287	6,365	6,531
Total domestic deposits	2,757	54,534	14,142	10,953	67,495	7,640	8,760
Noninterest-bearing deposits in foreign offices	0	0	0	0	455	4	0
Interest-bearing deposits in foreign offices	0	1,658	75	35	7,274	1,263	0
Total foreign deposits	0	1,658	75	35	7,729	1,266	0
Total deposits	2,757	56,192	14,218	10,988	75,224	8,907	8,760
Federal funds purchased and securities sold under agreements to repurchase	155	8,703	763	1,594	12,220	950	1,478
Interest-bearing demand notes issued to the U.S. Treasury	9	264	112	28	1,324	105	67
Other liabilities for borrowed money	8	343	38	44	3,220	892	34
Mortgage indebtedness and liability for capitalized leases	5	50	7	13	67	3	9
Subordinated notes and debentures	9	36	14	36	631	90	59
All other liabilities	46	1,132	212	564	4,440	285	137
Total liabilities	2,989	66,719	15,363	13,267	97,124	11,230	10,544
Limited-life preferred stock	0	0	0	0	—	0	0
Equity capital							
Perpetual preferred stock	0	3	173	2	0	20	0
Common stock	59	722	214	104	638	43	65
Surplus	63	1,597	361	216	1,711	236	218
Undivided profits and capital reserves	92	2,431	462	656	2,935	359	457
Cumulative foreign currency translation adjustments	0	0	0	0	4	—	0
Total equity capital	214	4,753	1,210	978	5,287	658	740
Total liabilities, limited-life preferred stock, and equity capital	3,203	71,472	16,574	14,245	102,412	11,888	11,284
Number of banks with foreign offices	0	8	3	2	6	2	1

See notes at end of table

Consolidated foreign and domestic assets, liabilities and capital accounts of national banks, by states, December 31, 1987—continued
(Dollar amounts in millions)

	South Dakota	Tennessee	Texas	Utah	Vermont	Virginia	Washington
Assets							
Cash and balances due from depository institutions							
Noninterest-bearing balances and currency and coin							
Interest-bearing balances							
Securities							
Federal funds sold and securities purchased under agreements to resell							
Loans and leases, net of unearned income							
Less allowance for loan and lease losses							
Less allocated transfer risk reserve							
Net loans and leases							
Premises and fixed assets							
Other real estate owned							
Other assets							
Total assets							
Liabilities							
Noninterest-bearing deposits in domestic offices							
Interest-bearing deposits in domestic offices							
Total domestic deposits							
Noninterest-bearing deposits in foreign offices							
Interest-bearing deposits in foreign offices							
Total foreign deposits							
Total deposits							
Federal funds purchased and securities sold under agreements to repurchase							
Interest-bearing demand notes issued to the U.S. Treasury							
Other liabilities for borrowed money							
Mortgage indebtedness and liability for capitalized leases							
Subordinated notes and debentures							
All other liabilities							
Total liabilities							
Limited-life preferred stock							
Equity capital							
Perpetual preferred stock							
Common stock							
Surplus							
Undivided profits and capital reserves							
Cumulative foreign currency translation adjustments							
Total equity capital							
Total liabilities, limited-life preferred stock, and equity capital							
Number of banks with foreign offices							

See notes at end of table

Consolidated foreign and domestic assets, liabilities and capital accounts of national banks, by states, December 31, 1987—continued
(Dollar amounts in millions)

	West Virginia	Wisconsin	Wyoming	Puerto Rico	D C — nonnational*
Number of banks	95	118	37	1	1
Assets					
Cash and balances due from depository institutions:					
Noninterest-bearing balances and currency and coin	\$ 417	\$ 1,469	\$ 124	\$ 2	\$ 9
Interest-bearing balances	153	369	72	1	—
Securities	2,976	3,450	746	11	38
Federal funds sold and securities purchased under agreements to resell	500	532	185	8	—
Loans and leases, net of unearned income	4,756	10,081	893	45	57
Less allowance for loan and lease losses	56	236	31	—	1
Less allocated transfer risk reserve	0	0	0	0	0
Net loans and leases	4,700	9,844	861	44	56
Premises and fixed assets	187	305	30	1	1
Other real estate owned	24	37	26	0	—
Other assets	159	304	47	2	2
<i>Total assets</i>	9,115	16,310	2,091	70	107
Liabilities					
Noninterest-bearing deposits in domestic offices	1,163	3,069	303	7	34
Interest-bearing deposits in domestic offices	6,587	10,110	1,593	53	65
<i>Total domestic deposits</i>	7,751	13,179	1,896	60	98
Noninterest-bearing deposits in foreign offices	0	6	0	0	0
Interest-bearing deposits in foreign offices	0	200	0	0	0
<i>Total foreign deposits</i>	0	206	0	0	0
<i>Total deposits</i>	7,751	13,385	1,896	60	98
Federal funds purchased and securities sold under agreements to repurchase	412	1,405	23	3	—
Interest-bearing demand notes issued to the U.S. Treasury	19	144	3	0	0
Other liabilities for borrowed money	10	41	—	0	0
Mortgage indebtedness and liability for capitalized leases	5	11	1	0	0
Subordinated notes and debentures	1	16	3	0	0
All other liabilities	91	241	16	1	1
<i>Total liabilities</i>	8,288	15,244	1,942	64	99
<i>Limited-life preferred stock</i>	0	0	0	0	0
Equity capital					
Perpetual preferred stock	0	0	0	0	0
Common stock	92	170	14	2	—
Surplus	216	335	56	4	1
Undivided profits and capital reserves	519	561	80	0	6
Cumulative foreign currency translation adjustments	0	—	0	0	0
<i>Total equity capital</i>	827	1,066	149	6	7
<i>Total liabilities, limited-life preferred stock and equity capital</i>	9,115	16,310	2,091	70	107
Number of banks with foreign offices	0	2	0	0	0

*Nonnational banks in the District of Columbia are supervised by the Comptroller of the Currency. Nonnational bank data are not included in U.S. aggregates.
 NOTES: Foreign offices are defined to include Edge Act and Agreement subsidiaries in the U.S., branches located in Puerto Rico, the Virgin Islands and U.S. Trust Territories and branches and subsidiaries located in foreign countries. Dashes indicate amounts of less than \$500,000. Data are from the consolidated reports of condition filed quarterly by all national banks.

Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1987
(Dollar amounts in millions)

	Total United States	Alabama	Alaska	Arizona	Arkansas	California	Colorado
Number of banks	4,623	53	3	15	83	168	241
Interest income	\$109,795.4	\$ 806.4	\$115.6	\$1,170.8	\$519.5	\$13,283.9	\$1,017.2
Interest and fee income on loans	2,233.9	2.7	0.2	18.8	1.8	309.2	1.5
Income from lease financing receivables	7,038.7	19.6	1.8	15.0	13.0	707.7	34.1
Interest income on balances due from depository institutions	20,809.7	267.0	42.7	187.8	197.5	1,037.8	238.8
Interest and dividend income on securities	2,455.0	2.6	0.0	1.2	3.9	339.3	4.2
Interest income from assets held in trading accounts	5,155.5	18.7	9.8	14.4	33.2	533.4	76.8
Interest income from federal funds sold and securities purchased under agreements to resell	147,488.1	1,117.0	170.2	1,408.1	768.9	16,211.3	1,377.5
<i>Total interest income</i>							
Interest expense	68,113.9	536.1	58.8	678.8	382.1	7,459.1	611.8
Interest on deposits	10,903.7	96.9	13.6	38.2	16.8	615.5	89.0
Expense of federal funds purchased and securities sold under agreements to repurchase	8,193.4	5.3	2.1	3.1	3.1	713.9	9.8
Interest on demand notes issued to the U.S. Treasury and on other borrowed money	159.9	1.1	0.1	0.9	0.6	22.9	1.6
Interest on mortgage indebtedness and obligations under capitalized leases	839.2	—	0.0	2.6	1.4	226.7	3.0
Interest on notes and debentures subordinated to deposits	88,210.2	639.4	74.6	723.6	404.0	9,038.0	715.2
<i>Total interest expense</i>							
Net interest income	59,277.9	477.6	95.6	684.4	364.9	7,173.2	662.3
Provision for loan and lease losses	24,302.9	64.5	11.5	293.8	75.5	3,600.1	209.7
Provision for allocated transfer risk	66.5	0.0	0.0	0.0	0.0	61.7	0.0
Noninterest income	5,270.0	52.7	11.9	102.9	39.8	786.4	105.8
Service charges on deposit accounts	20,514.9	123.7	23.5	132.0	105.9	2,824.0	204.3
Other noninterest income	25,784.8	176.5	35.4	235.0	145.7	3,610.4	310.1
<i>Total noninterest income</i>							
Gains and losses on securities not held in trading accounts	822.7	4.2	0.9	5.7	3.9	32.9	9.0
Noninterest expense:							
Salaries and employee benefits	26,831.5	205.2	47.3	347.0	155.5	3,756.1	325.1
Expenses of premises and fixed assets (net of rental income)	9,326.1	65.2	18.8	105.6	51.5	1,469.7	119.8
Other noninterest expense	22,363.7	146.1	24.6	200.4	135.9	2,616.9	328.3
<i>Total noninterest expense</i>	58,521.3	416.5	90.7	653.1	342.9	7,842.7	773.2
Income (loss) before income taxes and extraordinary items and other adjustments	2,994.7	177.3	29.7	-21.9	96.1	-688.0	-1.5
Applicable income taxes	2,659.2	32.0	1.8	-38.0	17.0	-16.3	-22.8
Income before extraordinary items and other adjustments	335.5	145.3	27.9	16.2	79.1	-671.6	21.3
Extraordinary items and adjustments, net of taxes	107.0	—	0.0	0.1	1.3	41.2	0.3
Net income	442.5	145.3	27.9	16.2	80.3	-630.4	21.6
Total cash dividends declared	6,322.8	69.4	14.5	66.5	61.0	328.6	62.7
Recoveries credited to allowance for possible loan losses	2,476.4	11.4	1.1	21.0	16.9	565.1	25.7
Losses charged to allowance for possible loan losses	13,160.9	70.9	8.6	210.6	98.1	1,811.0	202.3
Net loan losses	10,684.4	59.5	7.6	189.5	81.2	1,245.9	176.6

Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1987 — continued
(Dollar amounts in millions)

	Connecticut	Delaware	District of Columbia	Florida	Georgia	Hawaii	Idaho
Number of banks	17	17	20	161	55	3	6
Interest income	\$1,261.7	\$2,330.3	\$ 921.6	\$4,725.0	\$2,134.0	\$13.2	\$353.3
Interest and fee income on loans	—	4.2	3.3	30.7	41.6	0.1	4.3
Income from lease financing receivables	17.5	2.3	135.1	83.6	70.8	0.1	28.1
Interest income on balances due from depository institutions	235.0	35.7	207.1	1,238.7	445.2	3.9	78.2
Interest and dividend income on securities	1.6	0.0	2.9	3.2	8.1	0.0	0.1
Interest income from assets held in trading accounts	20.9	9.0	20.7	211.2	70.1	1.7	7.7
Interest income from federal funds sold and securities purchased under agreements to resell	1,536.7	2,381.6	1,290.6	6,292.4	2,769.7	19.1	471.7
<i>Total interest income</i>							
Interest expense	589.4	391.5	658.1	2,761.9	1,112.6	8.7	214.2
Interest on deposits	204.9	238.7	106.2	449.6	286.1	0.1	32.5
Expense of federal funds purchased and securities sold under agreements to repurchase	36.3	351.3	22.4	50.8	19.2	0.1	3.6
Interest on demand notes issued to the U.S. Treasury and on other borrowed money	1.8	0.3	0.9	6.7	2.5	—	0.3
Interest on mortgage indebtedness and obligations under capitalized leases	10.9	13.4	12.2	15.6	27.0	0.1	1.6
Interest on notes and debentures subordinated to deposits							
<i>Total interest expense</i>	843.2	995.2	799.9	3,284.7	1,447.5	9.0	252.2
Net interest income	693.5	1,386.4	490.8	3,007.8	1,322.2	10.1	219.5
Provision for loan and lease losses	56.5	666.7	130.7	477.9	225.1	0.2	23.5
Provision for allocated transfer risk	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Noninterest income	71.0	6.7	47.4	360.4	192.4	1.1	29.5
Service charges on deposit accounts	164.4	557.1	102.7	608.2	219.8	2.0	28.5
Other noninterest income	235.5	563.8	150.1	968.7	412.3	3.1	58.0
<i>Total noninterest income</i>	18.3	12.3	8.4	12.4	11.3	—	0.9
Gains and losses on securities not held in trading accounts							
Noninterest expense	338.3	172.2	217.6	1,183.1	575.1	5.7	83.8
Salaries and employee benefits	118.9	52.5	88.8	491.8	195.1	2.7	15.5
Expenses of premises and fixed assets (net of rental income)	187.3	633.4	150.6	1,040.7	406.4	3.1	86.2
Other noninterest expense	644.5	858.1	457.0	2,715.6	1,176.6	11.5	185.5
<i>Total noninterest expense</i>	245.8	437.7	61.6	795.4	344.1	1.4	69.4
Income (loss) before income taxes and extraordinary items and other adjustments	74.0	183.4	12.8	165.0	48.1	0.6	22.0
Applicable income taxes	171.8	254.3	48.7	630.4	296.0	0.7	47.4
Income before extraordinary items and other adjustments	0.1	0.0	0.1	1.5	1.8	—	—
Extraordinary items and adjustments, net of taxes	171.9	254.3	48.9	631.9	297.9	0.8	47.4
Net income	35.9	47.2	36.5	255.9	182.8	0.2	18.0
Total cash dividends declared	10.7	58.4	13.9	73.4	42.0	0.2	13.2
Recoveries credited to allowance for possible loan losses	36.5	589.3	66.6	417.7	234.5	0.2	41.2
Losses charged to allowance for possible loan losses	25.8	531.0	52.7	344.3	192.4	0.1	27.9
Net loan losses							

Ratio to total operating income							
Interest on deposits	33.3	13.3	45.7	38.0	35.0	39.4	40.4
Other interest expense	14.3	20.5	9.8	7.2	10.5	1.3	7.2
Salaries and employee benefits	19.1	5.8	15.1	16.3	18.1	25.9	15.8
Other noninterest expense	17.3	23.3	16.6	21.1	18.9	26.2	19.2
Total operating expenses	83.9	62.9	87.2	82.6	82.5	92.7	82.6
Ratio of net income to total equity capital (end of period)—percent							
	14.5	18.8	5.2	12.9	14.0	5.0	12.6

See notes at end of table.

Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1987 — continued
(Dollar amounts in millions)

	Illinois	Indiana	Iowa	Kansas	Kentucky	Louisiana	Maine
Number of banks	387	102	103	167	79	65	
Interest income							
Interest and fee income on loans	\$6,208.3	\$1,601.3	\$456.3	\$539.3	\$779.9	\$1,105.8	\$224.8
Income from lease financing receivables	25.3	28.0	0.9	4.0	12.1	4.5	0.4
Interest income on balances due from depository institutions	767.3	60.4	7.6	11.8	15.8	32.7	2.5
Interest and dividend income on securities	1,326.2	483.8	216.5	274.4	225.6	415.8	26.7
Interest income from assets held in trading accounts	152.1	2.3	0.5	0.4	1.1	0.5	0.0
Interest income from federal funds sold and securities purchased under agreements to resell	316.4	62.4	35.8	43.2	39.4	59.1	3.3
<i>Total interest income</i>	8,795.6	2,238.2	717.8	873.1	1,074.0	1,618.4	259.9
Interest expense							
Interest on deposits	4,544.6	1,077.2	364.7	446.2	508.4	784.1	120.0
Expense of federal funds purchased and securities sold under agreements to repurchase	650.9	174.2	29.8	29.7	81.8	98.7	8.4
Interest on demand notes issued to the U. S. Treasury and on other borrowed money	479.5	33.1	3.5	4.5	17.4	4.6	5.5
Interest on mortgage indebtedness and obligations under capitalized leases	2.6	2.7	1.4	0.7	1.8	1.4	0.2
Interest on notes and debentures subordinated to deposits	40.9	1.2	1.8	0.4	0.3	2.9	
<i>Total interest expense</i>	5,718.5	1,288.4	401.2	481.6	609.7	891.6	134.2
Net interest income							
Provision for loan and lease losses	3,077.1	949.9	316.6	391.5	464.3	726.8	125.7
Provision for allocated transfer risk	2,176.9	186.1	41.3	73.6	92.2	248.8	10.0
	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Noninterest income							
Service charges on deposit accounts	197.3	82.1	29.6	38.2	42.4	78.6	7.7
Other noninterest income	1,167.4	194.9	77.7	72.9	67.8	134.3	28.5
<i>Total noninterest income</i>	1,364.7	276.9	107.3	111.0	110.2	212.9	36.2
Gains and losses on securities not held in trading accounts							
Noninterest expense							
Salaries and employee benefits	29.4	9.2	4.4	8.5	0.4	20.8	1.8
Expenses of premises and fixed assets (net of rental income)	1,554.3	375.5	124.3	158.6	188.1	295.8	54.2
Other noninterest expense	470.0	128.1	36.4	45.7	62.1	99.1	19.5
	1,077.0	301.9	126.1	127.1	125.9	254.6	34.0
<i>Total noninterest expense</i>	3,101.4	805.4	286.7	331.4	376.2	649.5	107.7
Income (loss) before income taxes and extraordinary items and other adjustments							
Applicable income taxes	-807.1	244.5	100.3	106.1	106.5	62.2	46.1
Income before extraordinary items and other adjustments	10.1	44.2	26.8	26.8	4.1	15.5	14.3
Extraordinary items and adjustments, net of taxes	-817.2	200.3	73.5	79.3	102.4	46.7	31.8
	6.3	1.4	1.2	1.0	2.6	0.2	0.0
Net income	-810.9	201.7	74.7	80.3	105.0	46.9	31.8
Total cash dividends declared							
	428.3	122.0	42.3	66.5	45.7	87.1	9.9
Recoveries credited to allowance for possible loan losses	104.3	24.6	16.4	13.1	13.4	31.4	1.7
Losses charged to allowance for possible loan losses	691.3	142.8	53.4	85.3	80.3	243.6	4.6
Net loan losses	587.0	118.2	37.0	72.2	66.9	212.2	2.9

Ratio to total operating income:							
Interest on deposits	44.7	42.8	44.2	45.3	42.9	42.8	40.5
Other interest expense	11.6	8.4	4.4	3.6	8.6	5.9	4.8
Salaries and employee benefits	15.3	14.9	15.1	16.1	15.9	16.2	18.3
Other noninterest expense	15.2	17.1	19.7	17.6	15.9	19.3	18.0
Total operating expenses	86.8	83.2	83.4	82.6	83.3	84.2	81.7
Ratio of net income to total equity capital (end of period)—percent							
	-14.1	10.3	11.2	9.4	10.3	3.4	16.6

Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1987 — continued
(Dollar amounts in millions)

	Maryland	Massachu- setts	Michigan	Minnesota	Mississippi	Missouri	Montana
Number of banks	26	41	92	198	28	99	60
Interest income							
Interest and fee income on loans	\$1,363.4	\$4,026.7	\$2,400.1	\$1,988.7	\$461.1	\$1,460.2	\$192.7
Income from lease financing receivables	32.1	242.8	20.4	12.1	0.2	12.6	0.2
Interest income on balances due from depository institutions	39.7	298.1	239.2	151.7	8.0	39.2	4.5
Interest and dividend income on securities	344.2	619.2	589.0	680.0	190.7	367.7	59.9
Interest income from assets held in trading accounts	5.4	42.9	6.6	34.6	1.5	10.7	0.0
Interest income from federal funds sold and securities purchased under agreements to resell	57.8	54.1	105.1	196.3	36.1	148.7	63.2
<i>Total interest income</i>	1,842.6	5,283.9	3,360.5	3,063.5	697.5	2,039.1	320.5
Interest expense							
Interest on deposits	737.9	2,335.7	1,618.4	1,431.2	346.8	934.5	154.9
Expense of federal funds purchased and securities sold under agreements to repurchase	169.7	512.4	264.3	514.4	40.3	180.9	20.5
Interest on demand notes issued to the U.S. Treasury and on other borrowed money	73.1	532.6	47.3	78.8	2.1	31.7	1.2
Interest on mortgage indebtedness and obligations under capitalized leases	2.3	2.4	2.7	4.1	0.2	7.4	0.8
Interest on notes and debentures subordinated to deposits	11.8	17.6	12.9	20.8	0.2	0.1	0.9
<i>Total interest expense</i>	994.8	3,400.7	1,945.6	2,049.3	389.6	1,154.6	178.3
Net interest income							
Provision for loan and lease losses	847.8	1,883.2	1,414.9	1,014.1	307.9	884.5	142.3
Provision for allocated transfer risk	115.5	906.4	245.4	579.6	39.6	258.0	29.0
Provision for noninterest income	1.1	1.6	0.0	0.0	0.0	0.0	0.0
Noninterest income							
Service charges on deposit accounts	93.9	103.1	146.0	104.0	37.2	89.2	13.7
Other noninterest income	161.9	651.8	308.4	405.9	44.9	281.3	18.2
<i>Total noninterest income</i>	255.8	754.9	454.4	509.9	82.1	370.5	31.9
Gains and losses on securities not held in trading accounts							
Noninterest expense:							
Salaries and employee benefits	12.4	39.3	12.2	-19.5	3.2	6.3	1.8
Expenses of premises and fixed assets (net of rental income)	386.0	899.2	634.2	374.2	132.0	389.7	53.4
Other noninterest expense	132.7	313.7	189.1	114.9	43.7	126.3	17.9
	273.4	585.8	465.8	506.8	93.2	346.3	61.1
<i>Total noninterest expense</i>	792.1	1,798.7	1,289.2	996.0	269.0	862.2	132.3
Income (loss) before income taxes and extraordinary items and other adjustments							
Applicable income taxes	207.3	-29.3	346.9	-71.0	84.6	141.1	14.6
Income before extraordinary items and other adjustments	41.2	-65.7	78.6	-13.5	9.4	18.2	-0.3
Extraordinary items and adjustments, net of taxes	166.1	36.4	268.3	-57.5	75.2	122.8	14.9
	—	0.4	1.6	0.6	—	1.1	0.2
Net income	166.1	36.8	269.9	-56.8	75.2	123.9	15.2
Total cash dividends declared	42.7	108.3	218.6	179.5	31.5	145.3	12.2
Recoveries credited to allowance for possible loan losses	34.4	80.3	43.3	68.9	8.4	34.0	12.5
Losses charged to allowance for possible loan losses	150.0	394.7	177.0	450.7	42.3	149.4	47.0
Net loan losses	115.6	314.4	133.7	381.8	33.9	115.3	34.6

Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1987 — continued

(Dollar amounts in millions)

	Nebraska	Nevada	New Hampshire	New Jersey	New Mexico	New York	North Carolina
Number of banks	115	7	20	67	42	103	19
Interest income							
Interest and fee income on loans	\$518.3	\$731.9	\$386.0	\$3,379.1	\$358.4	\$21,013.3	\$2,469.1
Income from lease financing receivables	5.7	1.5	1.3	20.9	1.8	872.2	68.8
Interest income on balances due from depository institutions	6.5	7.0	0.9	41.7	4.6	2,615.2	135.2
Interest and dividend income on securities	233.3	56.3	41.1	732.4	109.4	2,498.8	777.2
Interest income from assets held in trading accounts	1.2	0.1	0.0	5.1	0.1	1,679.4	39.8
Interest income from federal funds sold and securities purchased under agreements to resell	28.0	5.1	4.2	80.1	30.5	810.8	98.8
Total interest income	792.9	801.9	433.5	4,259.3	504.7	29,489.7	3,589.0
Interest expense							
Interest on deposits	379.9	182.2	184.0	1,798.2	245.5	14,693.5	1,416.3
Expense of federal funds purchased and securities sold under agreements to repurchase	24.3	28.2	14.2	268.6	25.9	1,615.5	597.8
Interest on demand notes issued to the U. S. Treasury and on other borrowed money	10.4	107.6	10.5	36.0	1.1	4,029.0	75.5
Interest on mortgage indebtedness and obligations under capitalized leases	2.6	0.5	1.5	2.0	0.3	35.3	7.7
Interest on notes and debentures subordinated to deposits	0.5	11.2	—	17.5	0.8	170.1	20.1
Total interest expense	417.6	329.5	210.3	2,122.3	273.5	20,543.5	2,117.5
Net interest income	375.3	472.3	223.2	2,137.1	231.2	8,946.2	1,471.4
Provision for loan and lease losses	60.2	109.7	28.6	301.3	37.3	6,412.0	223.1
Provision for allocated transfer risk	0.0	0.0	0.0	0.0	0.0	0.4	0.0
Noninterest income							
Service charges on deposit accounts	29.8	29.0	9.4	199.9	25.6	318.4	157.9
Other noninterest income	130.8	89.6	34.5	296.0	41.4	5,565.8	458.6
Total noninterest income	160.6	118.6	44.0	495.9	67.0	5,884.2	616.6
Gains and losses on securities not held in trading accounts							
Noninterest expense:	0.8	3.4	1.4	12.3	9.0	339.6	57.0
Salaries and employee benefits	146.4	93.4	55.4	808.5	98.0	5,111.3	661.9
Expenses of premises and fixed assets (net of rental income)	46.4	42.8	20.2	299.9	33.3	1,762.0	229.2
Other noninterest expense	177.5	180.5	84.1	613.9	67.0	3,440.5	433.5
Total noninterest expense	370.3	316.6	159.7	1,722.2	198.2	10,313.9	1,324.6
Income (loss) before income taxes and extraordinary items and other adjustments	106.2	168.0	80.2	621.8	71.7	-1,556.2	597.3
Applicable income taxes	23.0	60.0	27.1	151.1	16.5	943.9	137.1
Income before extraordinary items and other adjustments	83.2	107.9	53.0	470.7	55.2	-2,500.2	460.2
Extraordinary items and adjustments, net of taxes	0.7	0.2	0.0	0.2	0.1	0.7	—
Net income	83.9	108.1	53.0	470.8	55.3	-2,499.5	460.2
Total cash dividends declared	37.4	46.8	11.9	221.1	30.9	1,145.4	355.8
Recoveries credited to allowance for possible loan losses	18.2	16.3	2.1	33.0	9.5	375.6	23.3
Losses charged to allowance for possible loan losses	80.2	118.0	19.3	158.5	43.2	1,446.1	190.6
Net loan losses	61.9	101.7	17.2	125.5	33.7	1,070.5	167.3

Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1987 — continued

(Dollar amounts in millions)

	North Dakota	Ohio	Oklahoma	Oregon	Pennsylvania	Rhode Island	South Carolina
Number of banks	41	139	206	8	169	5	22
Interest income							
Interest and fee income on loans	\$160.3	\$4,454.5	\$ 815.3	\$ 869.2	\$5,442.7	\$739.6	\$704.6
Income from lease financing receivables	0.6	108.1	0.8	16.1	140.9	67.0	7.5
Interest income on balances due from depository institutions	3.7	158.7	34.9	27.2	459.2	18.2	3.4
Interest and dividend income on securities	65.1	953.2	381.9	151.5	1,523.4	126.2	167.3
Interest income from assets held in trading accounts	0.1	5.5	5.7	3.6	41.4	1.1	2.9
Interest income from federal funds sold and securities purchased under agreements to resell	25.8	154.9	75.4	47.7	187.2	16.6	32.8
<i>Total interest income</i>	255.6	5,835.0	1,314.0	1,115.3	7,794.8	968.8	918.5
Interest expense							
Interest on deposits	135.2	2,651.6	689.4	463.3	3,679.3	447.3	368.5
Expense of federal funds purchased and securities sold under agreements to repurchase	8.3	485.9	54.5	86.8	778.2	50.9	85.2
Interest on demand notes issued to the U.S. Treasury and on other borrowed money	1.3	38.6	14.2	12.2	326.0	79.6	7.7
Interest on mortgage indebtedness and obligations under capitalized leases	0.4	4.6	1.4	1.2	6.2	0.7	0.7
Interest on notes and debentures subordinated to deposits	0.7	3.5	1.1	3.3	54.0	6.1	4.6
<i>Total interest expense</i>	145.9	3,184.1	760.7	566.9	4,843.7	584.6	466.7
Net interest income	109.6	2,651.0	553.3	548.4	2,951.0	384.2	451.8
Provision for loan and lease losses	20.8	583.7	224.1	136.2	1,443.6	156.1	32.3
Provision for allocated transfer risk	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Noninterest income							
Service charges on deposit accounts	9.0	223.5	67.8	68.7	238.2	15.6	53.8
Other noninterest income	14.7	777.9	194.5	90.1	1,010.2	200.3	72.7
<i>Total noninterest income</i>	23.7	1,001.4	262.3	158.8	1,248.4	215.9	126.4
Gains and losses on securities not held in trading accounts							
Noninterest expense	1.0	10.6	14.9	2.9	59.5	5.7	-0.6
Salaries and employee benefits	39.3	1,047.2	273.8	215.4	1,312.1	182.2	199.3
Expenses of premises and fixed assets (net of rental income)	14.0	327.4	92.1	60.5	454.0	39.6	69.1
Other noninterest expense	37.5	979.0	253.4	180.6	1,128.5	164.7	141.6
<i>Total noninterest expense</i>	90.8	2,353.5	619.3	456.5	2,894.6	386.4	410.0
Income (loss) before income taxes and extraordinary items and other adjustments							
Applicable income taxes	22.8	725.7	-12.9	117.3	-79.3	63.3	135.4
Income before extraordinary items and other adjustments	4.9	137.2	19.1	6.4	88.8	2.5	27.6
Extraordinary items and adjustments, net of taxes	17.9	588.4	-32.0	111.0	-168.1	60.8	107.8
	0.3	4.8	2.7	0.3	14.9	3.8	0.2
Net income	18.1	593.2	-29.2	111.3	-153.2	64.6	108.0
Total cash dividends declared	10.4	456.6	45.0	54.8	330.8	28.8	29.8
Recoveries credited to allowance for possible loan losses	6.7	103.6	31.2	12.9	87.1	9.0	7.0
Losses charged to allowance for possible loan losses	29.2	450.0	230.7	97.1	549.5	78.4	29.9
Net loan losses	22.5	346.4	199.5	84.2	462.4	69.4	22.9

Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1987 — continued
(Dollar amounts in millions)

	South Dakota	Tennessee	Texas	Utah	Vermont	Virginia	Washington
Number of banks	24	57	954	7	12	50	24
Interest income							
Interest and fee income on loans	\$2,078.4	\$1,325.8	\$7,176.0	\$438.7	\$135.0	\$1,523.4	\$2,058.4
Income from lease financing receivables	0.2	11.6	16.6	8.4	0.1	17.5	33.4
Interest income on balances due from depository institutions	2.5	35.5	522.3	31.7	0.9	46.7	39.4
Interest and dividend income on securities	75.7	367.6	1,426.6	46.3	17.3	307.0	169.6
Interest income from assets held in trading accounts	0.0	8.5	11.3	4.4	—	2.3	7.8
Interest income from federal funds sold and securities purchased under agreements to resell	34.9	43.0	970.1	24.8	2.9	69.8	71.5
<i>Total interest income</i>	2,191.6	1,792.1	10,122.9	554.2	156.3	1,966.6	2,380.3
Interest expense							
Interest on deposits	345.2	822.9	5,365.1	267.7	78.7	913.8	1,020.7
Expense of federal funds purchased and securities sold under agreements to repurchase	69.8	145.7	1,153.7	43.0	1.9	157.5	114.3
Interest on demand notes issued to the U. S. Treasury and on other borrowed money	555.2	21.8	232.3	3.6	0.7	26.8	54.7
Interest on mortgage indebtedness and obligations under capitalized leases	0.6	1.4	12.0	0.6	—	1.9	6.1
Interest on notes and debentures subordinated to deposits	35.4	6.1	49.9	3.5	0.1	2.0	21.4
<i>Total interest expense</i>	1,006.2	998.0	6,813.1	318.3	81.6	1,101.9	1,217.3
Net interest income							
Provision for loan and lease losses	1,185.4	794.1	3,309.8	235.9	74.8	864.7	1,163.1
Provision for allocated transfer risk	574.7	139.4	2,197.6	99.3	5.1	85.6	332.5
Noninterest income	0.0	0.0	0.6	0.0	0.0	0.0	0.0
Service charges on deposit accounts	11.8	98.7	493.6	32.7	5.6	76.6	157.8
Other noninterest income	987.2	250.8	832.4	44.6	9.4	189.7	302.0
<i>Total noninterest income</i>	999.0	349.5	1,326.0	77.3	15.0	266.3	459.7
Gains and losses on securities not held in trading accounts							
Noninterest expense	0.6	5.2	28.2	0.6	0.2	13.5	3.2
Salaries and employee benefits	156.6	351.0	1,589.4	86.7	31.0	329.5	586.0
Expenses of premises and fixed assets (net of rental income)	50.2	106.0	638.9	23.8	9.5	107.8	185.7
Other noninterest expense	764.4	338.0	1,861.8	118.8	19.3	298.4	400.1
<i>Total noninterest expense</i>	971.2	795.0	4,090.2	229.3	59.8	735.7	1,171.9
Income (loss) before income taxes and extraordinary items and other adjustments							
Applicable income taxes	639.1	214.4	-1,624.4	-14.8	25.2	323.2	121.6
Income before extraordinary items and other adjustments	264.3	42.1	-81.7	-16.8	7.2	69.6	14.1
Extraordinary items and adjustments, net of taxes	374.9	172.3	-1,542.7	2.0	17.9	253.7	107.5
Net income	0.9	1.2	9.3	0.0	0.0	0.1	0.3
Total cash dividends declared	375.8	173.5	-1,533.4	2.0	17.9	253.8	107.8
Recoveries credited to allowance for possible loan losses	22.6	96.3	344.8	16.7	6.5	101.3	67.9
Losses charged to allowance for possible loan losses	96.9	22.4	177.0	5.8	0.6	14.7	55.6
Net loan losses	680.8	108.0	1,730.1	91.8	3.7	85.0	260.8
	584.0	85.6	1,553.1	86.0	3.1	70.3	205.2

Income and expenses of foreign and domestic offices and subsidiaries of national banks, by states, December 31, 1987 — continued

(Dollar amounts in millions)

	West Virginia	Wisconsin	Wyoming	Puerto Rico	Disseminated
Number of banks	95	118	37	1	1
Interest income					
Interest and fee income on loans	\$478.5	\$972.2	\$100.7	\$4.7	\$5.9
Income from lease financing receivables	0.2	12.8	0.1	0.0	0.0
Interest income on balances due from depository institutions	11.6	20.5	4.1	0.1	0.0
Interest and dividend income on securities	236.5	254.9	53.5	0.9	2.4
Interest income from assets held in trading accounts	0.4	8.0	0.4	0.0	0.0
Interest income from federal funds sold and securities purchased under agreements to resell	39.0	41.5	10.9	0.3	0.4
<i>Total interest income</i>	766.2	1,309.9	169.6	6.0	8.8
Interest expense					
Interest on deposits	386.7	621.3	86.9	3.0	3.4
Expense of federal funds purchased and securities sold under agreements to repurchase	26.8	98.7	3.6	0.2	0.1
Interest on demand notes issued to the U.S. Treasury and on other borrowed money	2.1	10.4	0.2		0.0
Interest on mortgage indebtedness and obligations under capitalized leases	0.5	1.2	0.1	0.0	0.0
Interest on notes and debentures subordinated to deposits	0.2	0.7	0.2	0.0	0.0
<i>Total interest expense</i>	416.3	732.3	90.9	3.2	3.5
Net interest income					
Provision for loan and lease losses	349.9	577.6	78.7	2.8	5.3
Provision for allocated transfer risk	25.5	208.1	27.3	0.4	0.6
Noninterest income	0.0	0.7	0.0	0.0	0.0
Service charges on deposit accounts	16.7	50.3	8.1	0.3	0.5
Other noninterest income	34.7	165.7	8.9	0.3	0.2
<i>Total noninterest income</i>	51.4	216.0	17.0	0.6	0.8
Gains and losses on securities not held in trading accounts					
Noninterest expense	4.7	0.3	-1.5	0.0	0.0
Salaries and employee benefits	125.6	265.8	33.6	1.1	2.2
Expenses of premises and fixed assets (net of rental income)	38.5	69.5	10.0	0.4	0.5
Other noninterest expense	97.9	210.5	32.4	1.0	1.4
<i>Total noninterest expense</i>	261.9	545.8	76.0	2.5	4.1
Income (loss) before income taxes and extraordinary items and other adjustments					
Applicable income taxes	118.6	39.3	-9.0	0.4	1.3
Income before extraordinary items and other adjustments	19.9	11.0	-5.1	0.0	0.2
Extraordinary items and adjustments, net of taxes	98.6	28.3	-3.9	0.4	1.2
Net income	—	2.6	0.4	0.0	0.0
Total cash dividends declared	98.7	30.9	-3.5	0.4	1.2
Recoveries credited to allowance for possible loan losses	64.4	73.7	3.7	0.0	0.1
Losses charged to allowance for possible loan losses	6.7	11.8	9.7	—	0.3
Net loan losses	29.2	105.6	44.9	0.2	0.8
	22.5	93.8	35.2	0.2	0.6

Ratio to total operating income					
Interest on deposits	47.3	40.7	46.5	45.5	35.6
Other interest expense	3.6	7.3	2.2	3.3	0.7
Salaries and employee benefits	15.4	17.4	18.0	16.2	23.4
Other noninterest expense	16.7	18.3	22.7	22.2	20.1
Total operating expenses	82.9	83.8	89.4	87.2	79.9
Ratio of net income to total equity capital (end of period)—percent	11.9	2.9	-2.3	6.8	15.7

*Nonnational banks in the District of Columbia are supervised by the Comptroller of the Currency. Nonnational bank data are not included in U.S. aggregates.

NOTES: Foreign offices are defined to include Edge Act and Agreement subsidiaries in the U.S., branches located in Puerto Rico, the Virgin Islands and U.S. Trust Territories and branches and subsidiaries located in foreign countries. Dashes indicate amounts of less than \$50,000. Data are from the consolidated reports of condition filed quarterly by all national banks.

*Income and expenses of foreign and domestic offices and subsidiaries
of national banks, December 31, 1987*
(Dollar amounts in millions)

	4,623 banks *	
	Consolidated foreign and domestic	Percent distribution
Interest income		
Interest and fee income on loans	\$109,795	74.4
Income from lease financing receivables	2,234	1.5
Interest income on balances due from depository institutions	7,039	4.8
Interest and dividend income on securities	20,810	14.1
Interest income from assets held in trading accounts	2,455	1.7
Interest income from federal funds sold and securities purchased under agreements to resell	5,155	3.5
<i>Total interest income</i>	<i>147,488</i>	<i>100.0</i>
Interest expense		
Interest on deposits	68,144	77.2
Expense of federal funds purchased and securities sold under agreements to repurchase	10,904	12.4
Interest on demand notes issued to the U.S. Treasury and on other borrowed money	8,193	9.3
Interest on mortgage indebtedness and obligations under capitalized leases	160	0.2
Interest on notes and debentures subordinated to deposits	839	1.0
<i>Total interest expense</i>	<i>88,210</i>	<i>100.1</i>
Net interest income	59,278	
Provision for loan and lease losses	24,303	
Provision for allocated transfer risk	67	
Noninterest income		
Service charges on deposit accounts	5,270	20.4
Other noninterest income	20,515	79.6
<i>Total noninterest income</i>	<i>25,785</i>	<i>100.0</i>
Gains and losses on securities not held in trading accounts	823	
Noninterest expense:		
Salaries and employee benefits	26,832	45.9
Expenses of premises and fixed assets (net of rental income)	9,326	15.9
Other noninterest expense	22,364	38.2
<i>Total noninterest expense</i>	<i>58,521</i>	<i>100.0</i>
Income (loss) before income taxes and extraordinary items and other adjustments	2,995	
Applicable income taxes	2,659	
Income before extraordinary items and other adjustments	336	
Extraordinary items and adjustments, net of taxes	107	
Net income	442	
Total cash dividends declared	6,323	
Recoveries credited to allowance for possible loan losses	2,476	
Losses charged to allowance for possible loan losses	13,161	
Net loan losses	10,684	
Ratio to total operating income:		
Interest on deposits	39.3	
Other interest expense	11.6	
Salaries and employee benefits	15.5	
Other noninterest expense	18.3	
Total operating expenses	84.7	
Ratio of net income (annualized) to:		
Total assets (end of period)	0.02	
Total equity capital	0.44	

*Reporting national banks.

Deposits of national banks, by states, December 31, 1987
(Dollar amounts in millions)

	<i>Total demand deposits at domestic offices</i>	<i>NOW and automatic transfer accounts</i>	<i>Non- transaction savings accounts</i>	<i>Time certificates of deposit of \$100,000 or more</i>	<i>Other large time deposits</i>	<i>All other time de- posits at domestic offices</i>	<i>Total deposits at foreign offices</i>	<i>Total consoli- dated deposits</i>	<i>Brokered deposits</i>
All national banks	\$273,377	\$106,541	\$306,382	\$181,787	\$18,784	\$252,904	\$211,006	\$1,350,781	\$23,023
Alabama	2,245	1,213	2,409	1,645	171	3,210	298	11,190	325
Alaska	589	126	688	367	3	342	1	2,115	178
Arizona	3,303	1,263	4,385	1,887	5	4,186	0	15,029	24
Arkansas	1,558	1,189	1,874	1,070	36	2,590	0	8,315	3
California	33,473	12,486	41,304	15,811	1,996	19,695	29,209	153,972	1,736
Colorado	3,710	1,837	3,877	1,768	255	2,374	272	14,094	13
Connecticut	4,781	1,452	3,584	1,081	685	3,334	919	15,835	249
Delaware	239	64	1,830	3,362	0	1,044	0	6,540	733
District of Columbia*	2,922	1,196	4,028	2,396	52	1,254	2,653	14,500	356
Florida	14,332	7,975	19,928	8,194	403	13,310	801	64,943	208
Georgia	7,110	2,226	6,047	3,644	164	5,441	744	25,377	984
Hawaii	50	31	88	31	0	17	0	218	0
Idaho	795	572	1,271	338	4	1,500	0	4,481	15
Illinois	14,605	4,477	14,488	12,100	1,306	13,542	25,938	86,455	882
Indiana	4,976	2,481	5,387	2,460	55	7,205	372	22,934	45
Iowa	1,771	1,052	1,739	457	2	2,994	0	8,015	15
Kansas	1,852	1,201	2,160	1,149	80	2,849	0	9,291	27
Kentucky	2,356	1,360	2,150	1,485	21	3,522	170	11,063	279
Louisiana	3,692	1,312	4,974	3,787	13	3,210	208	17,196	302
Maine	538	286	876	195	0	756	0	2,651	22
Maryland	3,987	1,052	5,065	2,068	15	3,107	1,402	16,697	599
Massachusetts	8,400	2,221	9,638	5,466	1,132	3,682	8,560	39,099	1,267
Michigan	7,503	2,317	9,995	4,227	131	8,429	2,565	35,167	643
Minnesota	6,092	2,492	4,887	6,662	225	5,834	2,639	28,831	2,194
Mississippi	1,388	688	1,455	1,331	18	2,390	0	7,271	51
Missouri	6,249	2,436	4,296	3,365	238	4,774	363	21,721	303
Montana	770	477	880	207	0	1,108	0	3,443	0
Nebraska	1,702	1,182	1,613	511	4	3,196	0	8,208	1
Nevada	977	423	1,039	686	0	531	0	3,655	112
New Hampshire	598	480	1,070	707	1	946	0	3,801	137
New Jersey	12,336	3,816	14,539	4,599	191	9,398	312	45,191	223
New Mexico	919	705	1,309	901	0	1,132	0	4,966	2
New York	35,351	7,304	34,390	14,957	6,459	17,893	113,631	229,985	1,208
North Carolina	6,720	2,781	7,532	5,571	175	6,601	2,853	32,232	756
North Dakota	510	462	498	199	0	1,087	0	2,757	0
Ohio	10,470	5,380	15,893	6,793	366	15,632	1,658	56,192	1,223
Oklahoma	2,978	1,641	2,825	2,398	50	4,250	75	14,218	57
Oregon	2,303	1,484	3,506	959	0	2,701	35	10,988	423
Pennsylvania	14,632	5,135	19,648	11,644	407	16,029	7,729	75,224	3,506
Rhode Island	1,268	449	2,151	1,388	497	1,886	1,266	8,907	840
South Carolina	2,229	1,361	2,219	801	4	2,146	0	8,760	3
South Dakota	483	458	707	1,732	1	1,590	0	4,971	1,192
Tennessee	3,968	2,193	3,185	2,934	28	5,609	201	18,118	135
Texas	22,001	8,660	16,111	29,112	3,257	20,681	4,134	103,956	619
Utah	1,204	595	1,359	650	9	1,455	127	5,400	73
Vermont	279	168	560	124	30	487	0	1,647	4
Virginia	3,417	2,050	4,099	3,802	90	5,489	46	18,993	864
Washington	5,228	2,109	6,337	2,473	42	5,269	1,618	23,076	78
West Virginia	1,158	749	2,297	608	12	2,927	0	7,751	26
Wisconsin	3,053	1,170	3,702	1,456	27	3,771	206	13,385	76
Wyoming	303	300	493	201	121	478	0	1,896	0
Puerto Rico	7	5	1	25	0	21	0	60	12

*Includes national and nonnational banks in the District of Columbia, all of which are supervised by the Comptroller of the Currency

Note: Figures may not add to totals due to rounding.

Loans of national banks, by states, December 31, 1987
(Dollar amounts in millions)

	Total loans gross	Loans secured by real estate	Loans to financial institutions	Loans to farmers	Commercial and industrial loans	Personal loans to individuals	Other loans	Total loans less un- earned income	Total loans at foreign offices
All national banks	\$1,124,413	\$344,338	\$24,830	\$13,333	\$295,520	\$205,043	\$97,742	\$1,115,563	\$143,607
Alabama	8,884	3,088	117	38	2,855	1,900	877	8,735	11
Alaska	1,470	451	79	1	611	120	204	1,469	3
Arizona	11,893	4,155	193	538	3,241	3,017	743	11,883	7
Arkansas	5,327	2,186	51	154	1,430	1,102	405	5,274	0
California	137,020	46,863	635	1,939	30,266	18,777	9,158	136,783	29,384
Colorado	9,715	3,734	42	445	2,863	1,961	660	9,704	10
Connecticut	13,745	6,271	17	21	4,286	2,539	532	13,609	79
Delaware	17,344	889	26	2	437	15,880	110	17,344	0
District of Columbia*	10,961	4,301	434	0	3,091	1,026	1,304	10,913	804
Florida	50,500	23,073	522	208	10,823	12,618	3,045	49,625	211
Georgia	22,020	7,235	151	59	6,601	5,267	2,477	21,920	230
Hawaii	133	75	0	0	44	13	2	133	0
Idaho	3,458	863	0	312	972	1,032	279	3,443	0
Illinois	68,955	13,549	2,525	699	23,927	6,925	8,499	68,596	12,831
Indiana	17,074	5,465	441	237	4,625	4,386	1,749	16,969	171
Iowa	4,682	1,521	66	440	1,057	1,209	385	4,664	5
Kansas	5,384	1,668	25	720	1,525	1,039	407	5,368	0
Kentucky	8,576	2,558	42	110	2,742	1,941	1,138	8,444	44
Louisiana	11,749	4,259	61	58	3,659	2,174	1,231	11,653	308
Maine	2,349	1,266	0	13	602	366	102	2,338	0
Maryland	14,329	5,012	118	40	3,720	3,461	1,528	14,299	450
Massachusetts	39,872	12,375	662	40	14,545	3,612	3,680	39,710	4,958
Michigan	25,567	8,266	232	109	8,694	4,468	2,394	25,519	1,403
Minnesota	21,335	4,906	213	408	8,414	3,236	3,345	21,224	814
Mississippi	4,905	1,854	162	59	1,188	1,306	336	4,761	0
Missouri	15,340	5,575	151	270	4,127	2,948	2,004	15,274	264
Montana	1,832	467	75	218	569	405	98	1,827	0
Nebraska	4,921	1,064	105	957	1,054	1,324	417	4,919	0
Nevada	5,537	891	7	16	740	3,782	99	5,534	0
New Hampshire	3,666	1,395	4	1	744	1,410	111	3,662	0
New Jersey	38,193	17,073	747	8	11,415	6,012	2,724	37,716	214
New Mexico	3,316	1,439	32	89	903	723	131	3,286	0
New York	196,136	40,661	10,185	305	32,333	16,595	13,220	192,805	82,837
North Carolina	28,788	10,546	225	181	8,927	4,922	3,536	28,769	450
North Dakota	1,539	437	31	226	421	324	100	1,538	0
Ohio	46,562	13,765	683	271	13,452	14,149	3,938	46,252	305
Oklahoma	7,954	3,141	89	581	2,195	1,026	922	7,915	0
Oregon	8,876	2,568	52	219	3,456	1,751	750	8,851	80
Pennsylvania	61,348	15,446	2,223	128	21,662	9,107	9,569	60,813	3,214
Rhode Island	8,292	3,282	95	2	2,794	957	1,019	8,283	142
South Carolina	7,387	2,675	109	37	2,096	1,793	676	7,296	0
South Dakota	14,492	449	37	249	545	13,029	183	14,465	0
Tennessee	14,171	4,942	345	82	4,044	3,124	1,632	14,006	1
Texas	80,441	31,151	2,176	1,673	26,982	8,793	6,846	79,847	2,821
Utah	4,350	1,534	220	58	1,152	1,039	348	4,346	0
Vermont	1,371	765	0	17	335	217	37	1,371	0
Virginia	15,799	5,907	45	105	3,880	4,460	1,391	15,710	11
Washington	20,972	7,126	252	690	5,153	4,494	1,855	20,951	1,402
West Virginia	4,836	2,165	5	12	905	1,466	283	4,756	0
Wisconsin	10,105	3,702	121	190	3,100	1,628	1,222	10,081	143
Wyoming	897	279	3	100	301	176	39	893	0
Puerto Rico	46	14	0	0	17	14	0	45	0

* Includes national and nonnational banks in the District of Columbia, all of which are supervised by the Comptroller of the Currency

Note: Figures may not add to totals due to rounding

Outstanding balances, credit cards and related plans of national banks, December 31, 1987
(Dollar amounts in thousands)

	<i>Total number of national banks</i>	<i>Credit cards and other related credit plans</i>	
		<i>Number of national banks</i>	<i>Outstanding volume</i>
All national banks	4,624	2,367	\$62,194 054
Alabama	53	15	258 830
Alaska	3	2	56,436
Arizona	15	13	783,098
Arkansas	83	15	201,080
California	168	150	9,520,065
Colorado	231	204	712,144
Connecticut	17	10	511,383
Delaware	17	17	15,143,623
District of Columbia	20	18	145,932
Florida	161	78	2,345,563
Georgia	55	36	1,498,040
Hawaii	3	1	2,992
Idaho	6	5	173,436
Illinois	387	194	1,914,416
Indiana	102	78	879,966
Iowa	103	53	414,644
Kansas	167	39	229,732
Kentucky	79	34	172,396
Louisiana	65	23	432,283
Maine	7	7	57,061
Maryland	26	17	1,685,070
Massachusetts	41	32	955,442
Michigan	92	64	1,255,684
Minnesota	198	144	423,694
Mississippi	28	9	94,771
Missouri	99	54	656,115
Montana	60	35	19,676
Nebraska	115	40	638,783
Nevada	7	5	3,313 100
New Hampshire	20	15	941,920
New Jersey	67	47	704,987
New Mexico	42	13	198,154
New York	103	62	3,459,943
North Carolina	15	14	1,225,499
North Dakota	41	22	32,538
Ohio	139	105	3,348,292
Oklahoma	206	67	37,724
Oregon	8	6	605,375
Pennsylvania	169	72	845,395
Rhode Island	5	4	271,579
South Carolina	22	18	335,796
South Dakota	24	9	783,138
Tennessee	57	24	648,915
Texas	954	292	262,804
Utah	7	4	189,332
Vermont	12	5	40,823
Virginia	50	23	1,174,650
Washington	23	14	1,927,120
West Virginia	95	27	87,880
Wisconsin	118	102	561,038
Wyoming	37	28	9,419
Puerto Rico	1	1	5,886
District of Columbia—all*	21	19	146 324

*Includes the nonnational bank in the District of Columbia, which is supervised by the Comptroller of the Currency

National banks engaged in lease financing, December 31, 1987
(Dollar amounts in thousands)

	<i>Total number of national banks</i>	<i>Number of banks engaged in lease financing</i>	<i>Amounts of lease financing at domestic offices</i>
All national banks	4,624	1,069	\$18,884,726
Alabama	53	6	55,892
Alaska	3	1	4,736
Arizona	15	4	252,660
Arkansas	83	31	15,992
California	168	52	3,870,334
Colorado	231	79	109,233
Connecticut	17	2	629
Delaware	17	2	77,864
District of Columbia	20	7	57,723
Florida	161	25	326,613
Georgia	55	14	406,919
Hawaii	3	1	1,477
Idaho	6	3	99,619
Illinois	387	94	94,126
Indiana	102	47	330,710
Iowa	103	20	10,066
Kansas	167	39	35,613
Kentucky	79	23	154,602
Louisiana	65	13	52,164
Maine	7	2	8,041
Maryland	26	6	415,140
Massachusetts	41	17	2,087,925
Michigan	92	19	248,448
Minnesota	198	72	234,304
Mississippi	28	2	1,451
Missouri	99	25	201,292
Montana	60	7	801
Nebraska	115	28	73,106
Nevada	7	2	9,408
New Hampshire	20	5	9,822
New Jersey	67	16	291,318
New Mexico	42	15	15,286
New York	103	23	3,377,612
North Carolina	15	6	881,872
North Dakota	41	18	9,123
Ohio	139	66	1,201,995
Oklahoma	206	49	12,159
Oregon	8	3	241,423
Pennsylvania	169	30	1,512,322
Rhode Island	5	2	837,401
South Carolina	22	5	71,103
South Dakota	24	7	1,854
Tennessee	57	22	110,765
Texas	954	84	441,788
Utah	7	4	129,207
Vermont	12	1	1,624
Virginia	50	9	152,416
Washington	23	8	211,020
West Virginia	95	8	966
Wisconsin	118	37	135,781
Wyoming	37	8	981
Puerto Rico	1	0	0
District of Columbia—all*	21	7	57,723

* Includes the nonnational bank in the District of Columbia, which is supervised by the Comptroller of the Currency

Consolidated foreign and domestic loans and leases past due at national banks, by states, December 31, 1987
(Dollar amounts in millions)

	Number of banks	Type of loan						
		Real estate	Commercial and industrial	Personal	Leases	Other loans	Total loans	To non U S addresses
All national banks	4,624	\$18,828.6	\$19,960.2	\$7,676.76	\$372.267	\$15,003.6	\$61,841.5	\$8,490.63
Alabama	53	86.5	63.0	64.04	0.314	28.7	242.6	0.00
Alaska	3	59.7	31.6	2.79	0.160	3.0	97.3	0.00
Arizona	15	329.6	150.0	61.42	0.946	74.9	616.9	7.65
Arkansas	83	150.9	34.0	35.13	1.672	93.2	314.9	0.00
California	168	2,523.1	3,345.6	656.45	95.155	3,062.4	9,682.7	1,508.14
Colorado	231	274.5	47.3	70.90	1.680	271.1	665.5	0.25
Connecticut	17	152.2	156.3	72.85	0.000	21.8	403.2	24.57
Delaware	17	24.7	16.0	706.08	1.537	4.7	753.0	0.00
District of Columbia	21	160.8	117.1	21.39	1.285	112.1	412.7	29.59
Florida	161	802.9	330.7	273.97	8.969	144.8	1,561.4	28.75
Georgia	55	186.2	178.2	149.61	7.602	115.4	637.0	14.63
Hawaii	3	1.1	0.0	0.20	0.010	1.0	2.4	0.00
Idaho	6	40.4	37.6	21.92	0.514	21.0	121.4	0.00
Illinois	387	504.2	1,039.2	157.48	3.060	952.5	2,656.4	577.10
Indiana	102	123.9	98.6	120.80	8.271	106.4	458.1	4.89
Iowa	103	35.7	14.7	29.08	0.239	57.4	137.1	1.98
Kansas	167	54.5	14.9	23.95	1.263	81.6	176.1	0.09
Kentucky	79	99.5	56.4	40.16	1.095	56.7	253.8	0.00
Louisiana	65	440.2	276.9	126.75	3.523	94.0	941.3	0.86
Maine	7	27.8	9.1	13.38	0.095	4.2	54.5	0.00
Maryland	26	47.6	68.1	109.63	2.412	50.3	278.1	6.45
Massachusetts	41	620.7	741.8	137.19	43.861	750.0	2,293.6	321.24
Michigan	92	184.7	150.2	115.49	11.891	108.7	571.0	40.56
Minnesota	198	402.4	551.3	84.72	3.183	423.1	1,464.7	187.29
Mississippi	28	63.3	19.4	49.40	0.000	23.9	156.1	0.00
Missouri	99	191.2	223.5	79.02	3.956	229.3	726.9	54.40
Montana	60	31.0	8.0	14.66	0.600	55.5	109.7	0.00
Nebraska	115	34.2	13.5	36.15	1.603	67.7	153.1	0.00
Nevada	7	46.9	73.2	144.20	0.188	3.1	267.7	0.00
New Hampshire	20	23.2	13.2	25.12	0.000	8.8	70.3	0.00
New Jersey	67	430.1	396.6	164.72	7.992	129.0	1,128.4	24.42
New Mexico	42	70.1	46.1	21.61	0.341	57.5	195.6	0.00
New York	103	1,880.0	6,121.6	1,375.56	44.632	4,146.8	13,568.6	4,781.16
North Carolina	15	245.7	190.4	99.26	2.980	119.1	657.4	45.94
North Dakota	41	17.9	0.0	8.20	0.572	62.2	88.8	0.00
Ohio	139	390.3	505.0	409.86	30.102	191.9	1,527.2	50.68
Oklahoma	206	399.3	85.4	43.56	0.064	242.6	770.9	0.00
Oregon	8	190.5	71.7	39.63	0.830	35.6	338.3	1.04
Pennsylvania	169	647.6	1,252.1	256.42	24.889	793.3	2,974.4	272.41
Rhode Island	5	108.6	115.3	29.47	20.239	1.5	275.2	21.41
South Carolina	22	100.5	31.9	36.01	1.296	19.9	189.6	0.00
South Dakota	24	12.7	6.8	1,020.55	0.010	23.8	1,063.9	0.00
Tennessee	57	155.7	121.3	90.15	2.955	46.6	416.7	1.54
Texas	954	5,625.8	2,560.2	307.86	4.281	1,485.0	9,983.2	376.43
Utah	7	119.6	50.2	29.08	3.382	5.9	208.2	0.00
Vermont	12	14.2	9.9	6.77	0.000	4.6	35.5	0.00
Virginia	50	134.1	105.4	76.16	2.826	66.8	385.3	15.71
Washington	23	363.0	332.9	114.35	3.154	291.1	1,104.5	58.07
West Virginia	95	81.9	11.7	62.42	0.139	43.8	199.9	0.00
Wisconsin	118	95.0	66.2	29.40	16.444	154.7	361.8	33.38
Wyoming	37	22.2	0.0	11.34	0.055	53.5	87.0	0.00
Puerto Rico	1	0.0	0.0	0.42	0.000	1.1	1.6	0.00

Average national banks' percent of loans past due, by assets

	Assets in millions of dollars									
	<i>Less than \$10</i>	<i>\$10 to \$20</i>	<i>\$20 to \$25</i>	<i>\$25 to \$40</i>	<i>\$40 to \$100</i>	<i>\$100 to \$300</i>	<i>\$300 to \$900*</i>	<i>\$900 to \$5,000</i>	<i>\$5,000 or more</i>	<i>All national banks</i>
Real estate										
March 1987	4.9	6.5	5.9	6.2	5.4	4.9	4.9	5.3	5.7	5.6
June 1987	4.9	5.7	5.8	5.3	5.1	4.3	4.2	5.0	5.0	5.1
September 1987	5.3	5.9	5.7	5.4	4.9	4.3	4.4	4.9	4.9	5.1
December 1987	5.8	6.2	6.0	5.4	4.8	4.3	5.0	5.2	5.1	5.1
Commercial and industrial										
March 1987	NA	NA	NA	NA	NA	NA	6.1	5.0	6.2	5.6
June 1987	NA	NA	NA	NA	NA	NA	5.1	4.9	5.4	5.0
September 1987	NA	NA	NA	NA	NA	NA	5.7	4.8	5.1	5.1
December 1987	NA	NA	NA	NA	NA	NA	5.8	4.5	4.8	5.2
Personal										
March 1987	4.2	4.6	4.5	3.8	3.5	3.0	2.7	2.9	3.4	3.6
June 1987	4.2	4.2	3.7	3.3	3.3	2.9	2.3	3.0	3.0	3.3
September 1987	4.4	3.8	4.0	3.3	3.5	3.0	2.7	3.0	3.0	3.4
December 1987	4.2	3.8	4.5	3.5	3.3	3.2	3.1	3.0	2.8	3.5
Leases										
March 1987	9.0	7.8	4.0	4.8	4.8	4.0	1.7	4.1	2.2	4.2
June 1987	6.9	4.3	2.8	4.1	4.4	2.5	3.0	3.4	1.9	3.5
September 1987	6.2	0.5	3.8	3.2	4.2	3.6	2.0	4.7	2.6	3.5
December 1987	11.3	0.3	8.9	1.6	4.6	6.9	3.6	9.6	1.1	5.2
Other loans										
March 1987	10.0	10.2	9.1	8.7	8.3	6.9	2.5	2.4	6.4	8.2
June 1987	10.3	9.9	8.4	8.0	7.4	6.3	2.6	2.4	6.1	7.8
September 1987	10.3	9.8	9.2	7.7	7.1	6.7	2.7	3.5	5.6	7.9
December 1987	8.3	9.8	6.9	7.1	6.8	6.1	2.9	3.1	5.8	6.8
Total loans										
March 1987	5.8	7.0	6.3	6.3	5.8	5.2	4.4	4.4	5.7	5.9
June 1987	5.6	6.2	5.9	5.5	5.3	4.7	3.8	4.2	5.2	5.3
September 1987	5.2	6.0	5.9	5.4	5.1	4.7	3.9	4.2	4.8	5.2
December 1987	5.3	6.1	5.7	5.3	4.9	4.5	4.4	4.3	4.8	5.1

*Please note that some data in this column have been recalculated to correct previously undetected inconsistencies of treatment in the "Commercial and industrial" and "Other loans" categories.

See notes on next page.

NOTES

Changes in the report of condition format make comparisons to earlier periods difficult. Beginning with the report for March 1987, banks with assets of less than \$300 million and no foreign offices report nonaccrual loans in the appropriate categories. In earlier periods, nonaccrual loans were reported in the "Total loans" category.

Past due loans—These items are (1) single payment notes 30 days or more past maturity; (2) single payment notes with interest due at specified intervals and demand notes on which interest is due and unpaid for 30 days or more; (3) amortizing real estate loans and closed-end monthly installment loans and lease financing receivables in arrears two or more monthly payments, or, if scheduled other than monthly, when one scheduled payment is due and unpaid for 30 days or more; (4) open-end credit accounts on which the customer has not made the minimum monthly payment for two or more billing cycles; and (5) unplanned overdrafts outstanding 30 days or more after origination.

Nonaccrual loans—These items are (1) those maintained on a cash basis because of deterioration in the financial position of the borrower; and (2) those on which principal or interest has been in default for a period of 90 days or more unless the obligation is both well secured and in the process of collection, in which case it is considered merely past due.

Average banks' percent of loans past due—Percentages reported are averages of individual banks' percentages of loans past due with each bank accorded the same weight regardless of size; those individual bank percentages are based on dollar value of loans past due. All figures are as of the last day of the month indicated.

Loan categories—The loan categories for this table correspond to those for the report of condition except for "Other loans." "Other loans" includes loans to financial institutions, loans for purchasing or carrying securities, loans to farmers and all other loans not included in the specified categories. Banks with assets of less than \$300 million and no foreign offices report commercial and industrial loans as part of "Other."

Data for prior periods, based on slightly different definitions, may be found in the *Quarterly Journal*, Volume 2, Number 1, pp. 229-232, Volume 5, Number 1, pp. 213-215 and Volume 6, Number 2, pp. 117-119.

Beginning March 1987, past due loans for all national banks are reported on a fully consolidated, foreign and domestic basis.

The following is provided for additional information:

Commercial and industrial loans past due by address of borrower, * December 31, 1987
(Dollar amounts in millions)

	<i>Loans outstanding</i>	<i>Loans past due</i>	<i>Percent</i>
U.S. addresses	\$ 266,576.0	\$ 11,946.5	4.48
Non-U.S. addresses	65,450.4	8,013.4	12.24
Total	332,026.4	19,959.9	6.01

*Reported only by banks with foreign offices and/or assets of more than \$300 million.

Office of the Comptroller of the Currency — Financial Statements

December 31, 1987

Balance Sheets

Assets	December 31	
	1987	1986
Current assets:		
Cash	\$ 3,699,743	\$ 1,012,134
Receivables:		
Travel advances	830,354	753,036
Accounts receivable	2,111,356	1,309,841
Accrued interest	805,650	511,377
Total receivables	3,747,360	2,574,254
Investment securities	51,727,557	26,537,183
Prepaid expenses and other assets	658,386	1,041,519
Total current assets	59,833,046	31,165,090
Investment securities, long-term	26,901,567	42,512,942
Other non-current assets	150,000	200,000
Fixed assets and leasehold improvements:		
Furniture, equipment and software	18,213,741	15,606,636
Leasehold improvements	15,342,518	12,745,930
	33,556,259	28,352,566
Less accumulated depreciation and amortization	14,580,793	12,612,734
Net fixed assets and leasehold improvements	18,975,466	15,739,832
Total assets	\$105,860,079	\$89,617,864
Liabilities and Comptroller's Equity		
Current liabilities:		
Accounts payable and accrued expenses	\$ 16,292,030	\$ 6,132,386
Accrued travel and salaries	5,185,396	4,018,949
Total current liabilities	21,477,426	10,151,335
Long-term liabilities:		
Accumulated annual leave	9,503,948	8,884,837
Total liabilities	30,981,374	19,036,172
Comptroller's equity:		
Unrestricted	74,878,705	70,581,692
Total liabilities and equity	\$105,860,079	\$89,617,864

See accompanying notes to financial statements.

Office of the Comptroller of the Currency — Financial Statements

December 31, 1987

Statements of Revenue, Expenses and Changes in Comptroller's Equity

	Years ended December 31	
	1987	1986
Revenue:		
Semiannual assessments	\$188,846,444	\$181,432,333
Examinations and investigations	11,953,828	11,364,667
Investment income	7,920,791	6,830,058
Publication sales	426,283	1,086,883
Other	232,524	173,779
Total revenue	<u>209,379,870</u>	<u>200,887,720</u>
Expenses:		
Salaries	138,974,257	123,373,127
Travel	17,188,475	12,521,448
Relocation	2,681,883	3,311,173
Training	2,110,418	877,029
Conference expense	699,736	294,716
Office space costs	14,807,129	13,687,186
Office equipment and furniture	5,905,391	2,658,524
Office supplies, materials & services	1,940,547	1,703,563
Printing and copier	998,419	1,014,554
Automated services	13,070,981	10,706,233
Communications	5,238,182	3,608,494
Outside services	1,467,439	1,436,461
Total expenses	<u>205,082,857</u>	<u>175,192,508</u>
Excess of revenue over expenses	<u>4,297,013</u>	<u>25,695,212</u>
Comptroller's equity at beginning of year	70,581,692	44,886,480
Comptroller's equity at end of year	<u>\$ 74,878,705</u>	<u>\$ 70,581,692</u>
See accompanying notes to financial statements.		

Office of the Comptroller of the Currency — Financial Statements

December 31, 1987

Statements of Changes in Financial Position

	Years ended December 31	
	1987	1986
Financial resources were provided by:		
Operations:		
Excess of revenue over expenses	\$ 4,297,013	\$25,695,212
Charges not affecting working capital:		
Additions to accumulated annual leave	1,176,460	1,596,570
Depreciation and amortization	2,746,650	2,781,228
Amortization of premium and discount on long-term Government obligations, net	(39,454)	(43,868)
Net loss on sale of fixed assets	24,019	79,650
Working capital provided by operations	8,204,688	30,108,792
Proceeds from sale of fixed assets	54,212	11,894
Long-term U.S. Government obligations transferred to current assets	27,654,579	—
Total	35,913,479	30,120,686
Financial resources were used for:		
Purchase of fixed assets	6,060,516	5,494,021
Payment of accrued leave	557,349	850,491
Purchase of long-term securities	12,003,750	15,711,777
Transfer of short-term rent receivable to long-term receivable	150,000	200,000
Increase in working capital	18,771,615	22,256,289
	<u>\$17,141,864</u>	<u>\$ 7,864,397</u>
Analysis of changes in working capital:		
Increase (decrease) in current assets:		
Cash	\$ 2,687,609	\$ 123,183
Investment securities	25,190,374	1,910,419
Accrued interest	294,273	157,460
Accounts receivable	601,514	276,918
Travel advances	77,318	(197,658)
Prepaid expenses and other assets	(383,133)	(147,588)
	<u>28,467,955</u>	<u>2,122,734</u>
(Increase) decrease in current liabilities:		
Accounts payable and accrued expenses	(10,159,644)	5,984,526
Accrued travel and salaries	(1,166,447)	(242,863)
	<u>(11,326,091)</u>	<u>5,741,663</u>
Increase in working capital	<u>\$17,141,864</u>	<u>\$7,864,397</u>

See accompanying notes to financial statements.

Office of the Comptroller of the Currency

December 31, 1987

Notes to Financial Statements, December 31, 1987 and 1986

Note 1—Organization

The Office of the Comptroller of the Currency (Comptroller's Office) was created by an Act of Congress for the purpose of establishing and regulating a national banking system. The National Currency Act of 1863, rewritten and reenacted as The National Banking Act of 1864, created the Comptroller's Office and provided for its supervisory functions and the chartering of banks.

No funds derived from taxes or federal appropriations are allocated to or used by the Comptroller's Office in any of its operations. Revenue is derived principally from assessments and fees paid by the national banks and income on investments in U.S. Government obligations. The Comptroller's Office is exempt from federal and state income taxes.

Note 2—Significant Accounting Policies

The accounting policies of the Comptroller's Office conform to generally accepted accounting principles, accordingly, the financial statements are presented on the accrual basis of accounting.

Investment securities are U.S. Treasury obligations stated at amortized cost which approximates market value. Premiums and discounts on investment securities are amortized on a straight-line basis to maturity.

Furniture and equipment costing in excess of \$5,000 is capitalized at cost less accumulated depreciation calculated on a straight-line basis over the estimated useful lives of the assets, which range from 3 to 10 years. Leasehold improvements are capitalized at cost less accumulated amortization which is computed over the terms of the related leases (including renewal options) or the estimated useful lives of the leaseholds, whichever is shorter. Expenditures for maintenance and repairs are charged to expenses as incurred.

Note 3—Commitments

The Comptroller's Office occupies office space in Washington, DC, under a lease agreement which provided for an initial five-year term with five consecutive five-year renewal options. During 1984, the second of these options, expiring in 1989, was exercised. In addition, the district and field offices lease space under agreements

which expire at various dates through 2000. Minimum rental commitments under leases in effect at December 31, 1987 are as follows:

1988	\$13,974,000
1989	11,576,000
1990	9,155,000
1991	7,586,000
1992	7,035,000
1993 and after	\$32,407,000
	<u>\$81,733,000</u>

Certain of the leases provide that annual rentals may be adjusted to provide for increases in taxes and other related expenses. Total rental expense under leases was \$11,820,000 and \$11,622,000 for the years ended December 31, 1987 and 1986, respectively.

Note 4—Retirement Plans

The Comptroller's Office contributes to the Civil Service retirement plan and the Federal Employees' Retirement System administered by OPM for the benefit of all its eligible employees. Contributions aggregated \$9,935,000 and \$7,385,000 in 1987 and 1986, respectively. The plans are participatory, with 7 percent of salary being contributed by each party for the Civil Service retirement plan. Under the Federal Employees' Retirement System, the Comptroller's Office contributed 12.77 percent of salary and the participating employees contributed 1.3 percent.

Additionally, the Comptroller's Office contributed up to 5 percent of basic pay for participants in the Thrift Savings Plan under the Federal Employees' Retirement System. The Comptroller's Office also contributes to Social Security and Medicare on behalf of all eligible employees.

Note 5—Contingencies

Various banks in the District of Columbia have deposited securities with the Comptroller's Office as collateral for those banks entering into and administering trust department activities. These securities, having a par or stated value of \$17,393,000, are not assets of the Comptroller's Office and accordingly, are not included in the accompanying financial statements.

The Comptroller's Office is a defendant, together with other bank supervisory agencies and other persons, in litigation related to the closing of certain national banks. In the opinion of the Comptroller's legal counsel, the Comptroller's Office will be able to defend successfully against these complaints and no material liability is expected to result therefrom.

Price Waterhouse



Opinion of Independent Accountant

May 4, 1988

To the Comptroller of the Currency:

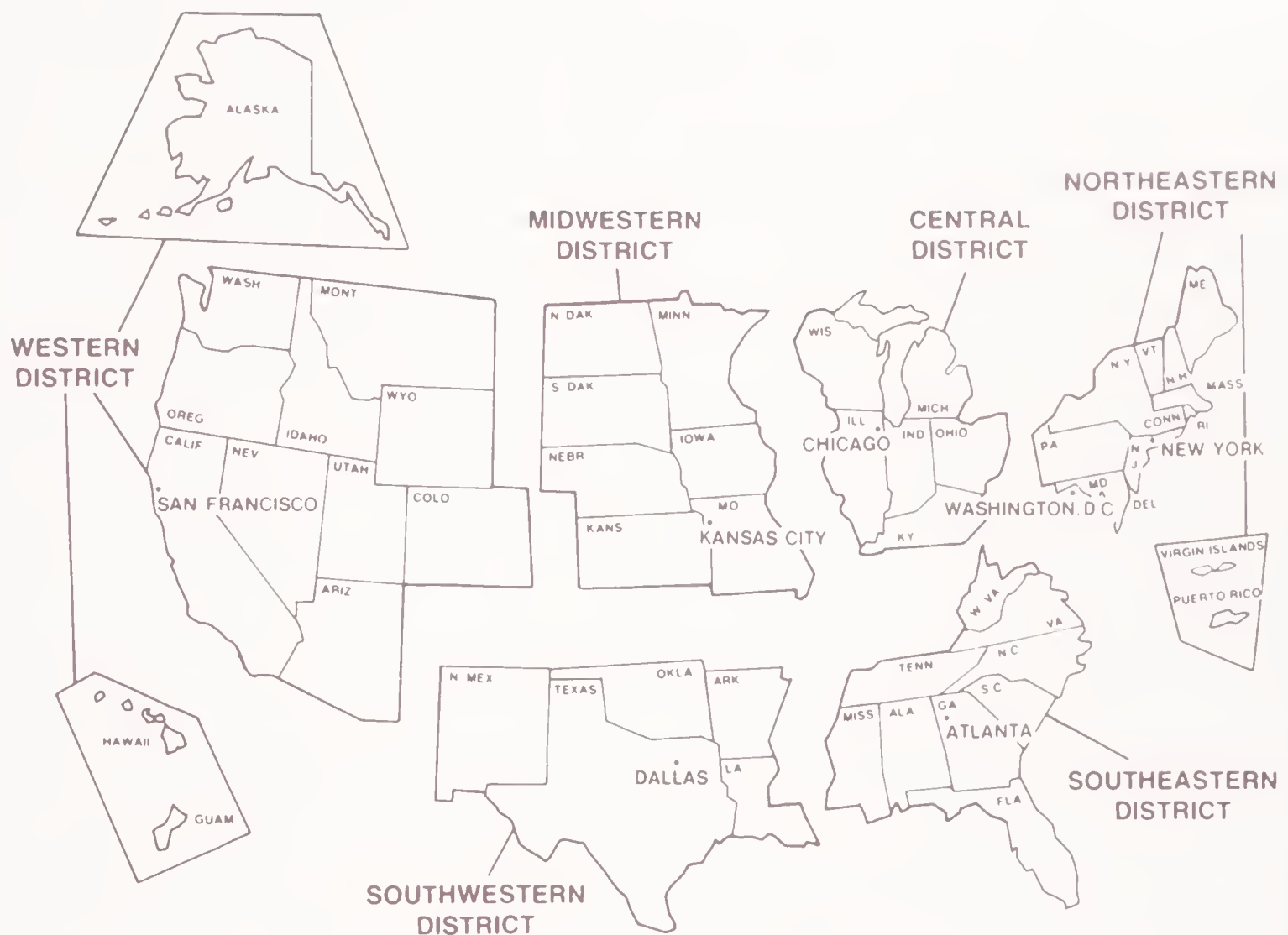
We have examined the balance sheets of the Office of the Comptroller of the Currency as of December 31, 1987 and December 31, 1986, and the related statements of revenue, expenses and changes in Comptroller's equity and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements examined by us present fairly the financial position of the Office of the Comptroller of the Currency at December 31, 1987 and 1986 and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied.

Price Waterhouse

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